

***Wage Reporting Simplification Project:
Overview of the Phase I
Feasibility Study***

Jointly Sponsored by:
The Internal Revenue Service
The Social Security Administration
The Department of Labor

The MITRE Corporation

May 1993

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EXECUTIVE SUMMARY

Today, the reporting of employee's wages and employer/employee wage-related taxes to the Federal and state agencies administering taxation, retirement, and employment security programs is burdensome to employers and costly to government. The current cost to the employer community of complying with Federal and state wage reporting laws and regulations is estimated to be in excess of \$6 billion per year. The corresponding current annual cost to government for processing-related returns and payments, and providing assistance to employers is estimated to be in excess of \$300 million. Opportunities exist to significantly reduce this employer burden while lowering the costs of government programs and improving compliance. The Wage Reporting Simplification Project (WRSP), the subject of this document, is targeted at achieving such objectives. Through a comprehensive effort at reducing the multiplicity and complexity of laws, regulation, and procedures, provision of one-stop employer assistance, and consolidation of returns and payment processing systems, it is estimated in this preliminary Phase I of the WRSP Feasibility Study that, over the next 15 years, employer burden may be reduced by up to \$13.5 billion, and government costs by as much as \$1.7 billion.

WRSP is an outgrowth of a series of activities carried out over the past five years by the Internal Revenue Service (IRS) and the Social Security Administration (SSA), and, more recently, by the Department of Labor (DOL). Recently, based on recommendations made by employer and state representatives, IRS and SSA carried out a high-level analysis of consolidated processing and distribution of state and Federal data from Annual Wage and Tax Statements (W-2s) and associated transmittals (W-3s). The results of this study looked quite promising and triggered interest by the Office of Management and Budget (OMB) and others in the potential for broader consolidation of activities. As a result, in mid-1992, WRSP was initiated. The goal of this project is to reduce the wage reporting burden on employers, while maintaining or improving the effectiveness of government operations. Agencies and wage-related reporting activities included in the WRSP scope are:

- IRS: Employer's quarterly and annual tax returns (e.g., Forms 941, 942, 943, and related returns), Employer's Annual Federal Unemployment Tax Returns, and Federal Tax Deposits)
- SSA: Annual Wage and Tax Statements (W-2s) and Transmittals of Annual Wage and Tax Statements (W-3s)
- DOL: Information reported to DOL through the states on administration of state employment security programs, and data needed to track the nation's employment and unemployment status

- **State Revenue Agencies:** Quarterly and annual employer wage-related tax returns, annual individual wage and tax reports (i.e., state W-2s or equivalent), and state withholdings and wage related tax payments
- **State Employment Security Agencies (SESAs):** Quarterly unemployment insurance (UI) contribution reports and payments, and quarterly employee wage reports

It is envisioned that participation in WRSP at the state level will be voluntary, with decisions as to participation being based on the benefits state executives, law makers and agency administrators see in the project. These benefits may be direct in the form of operational cost reduction and improved compliance programs, and indirect, by providing a regulatory and administrative climate which reduces employer burden, thus stimulating new business formation and location in participating states.

To investigate the feasibility of such a wage reporting project, a two phase study was initiated with the assistance of The MITRE Corporation. The first phase (Phase I), the subject of this report, is aimed at assessing high level project feasibility and includes the following:

- **Analysis of current employer and government activities associated with wage reporting**
- **Estimation of associated employer and government costs**
- **Identification of problems and opportunities for improvements in wage reporting**
- **Formulation of alternative project concepts addressing both scope and functionality**
- **Analysis of benefits and costs of these alternative WRSP concepts (Levels 1, 2, and 3)**
- **Identification of institutional, legal, and regulatory issues which may impact project implementation**

The second phase (Phase II) of this feasibility study will focus on assessment of the impacts of WRSP on major stakeholders, and on development and analysis of organizational options which reflect the capabilities of government agencies, Federal and state, to deliver required WRSP functionality. Also in Phase II, implementation strategies for a Simplified Tax and Wage Reporting System (STAWRS) will be developed. (Throughout this document, WRSP is used to refer to the overall project and its scope, while STAWRS is used to refer to

the functionality, and components of a system that provides wage reporting simplification services.)

This report on the findings of Phase I activities is intended to provide WRSP stakeholders with the results of analyses to date. Primary stakeholders and stakeholder representatives that have participated in the feasibility study to date through provision of data, site visits and/or participation in meetings and vision of commentary on draft material include:

- Federal level
 - Office of Management and Budget (OMB)
 - Internal Revenue Service (IRS)
 - Social Security Administration (SSA)
 - Department of Labor (DOL)
 - Small Business Administration (SBA)
- State level
 - State revenue agencies (6)
 - State employment security agencies (SESAs) (7)
 - Federation of Tax Administrators (FTA)
 - Interstate Conference of Employment Security Agencies (ICESA)
 - National Governors Association (NGA)
 - National Conference of State Legislators (NCSL)
 - National Conference of Commissioners on Uniform State Laws
- Employer community and employer agents
 - National Association of the Self Employed (NASE)
 - National Federation of Independent Business (NFIB)
 - Bureau of National Affairs (BNA)
 - American Payroll Association (APA)
 - American Society of Payroll Management (ASPM)
 - National Association of Enrolled Agents (NAEA)
 - American Institute of Certified Public Accountants (AICPA)
 - Tax Executives Institute (TEI)

Not directly represented thus far are individual employees, SSA beneficiaries, UI claimants and participants in other government programs. The study has, however, addressed several anticipated key concerns of these stakeholders in the specification of WRSP requirements related to availability, accuracy and timeliness of information needed to process

claims, and assurance of privacy and prevention of unauthorized disclosure of sensitive information.

CURRENT EMPLOYER BURDEN

The annual burden on employers associated with complying with Federal and state wage reporting laws, regulations and procedures is estimated to be between \$6 and \$9 billion. This estimate is based on analysis of data from OMB and from representatives of employers and their agents. Four categories of activities comprise this burden; these categories follow.

- **Tracing requirements:** Including identifying Federal and state agencies with which the employer must do business; registering; contacting agencies and obtaining forms and requirements for record keeping, filing, payment submission, and related procedures; understanding and resolving impacts on current operations; establishing internal manual or automated procedures needed to comply with government requirements, and related activities.
- **Record keeping:** Including tasks associated with the processing of employment and payroll records for the purpose of generation, accumulation, and recording of data necessary to prepare required forms and make required payments. This burden category does not include those record keeping tasks otherwise associated with preparing payroll and carrying out non-government related business management activities.
- **Preparing submissions:** Including the actual preparing and reconciling (within the business) documents for submission to the government; copying and submitting these documents; and the transferring of funds either by direct payment or via a deposit program.
- **Responding to government queries:** Including any tasks needed to deal with correspondence and notices and other queries and directives received from government entities related to wage and tax forms submitted and payments made.

With respect to wage reporting-related activities, the employer community is not monolithic. For the purposes of this feasibility study, two categories of employers have been defined. Designated small and large, these employer categories are characterized as follows.

- **Small employers:** Generally single state operations, with a single employee classification, simple or no benefits program, and mostly manual labor for record keeping, submission, and responding to government queries. A small percentage may use a payroll service to prepare pay checks and carry out routine bookkeeping. Ownership/management usually tracks government requirements personally or with the advice of a professional advisor (e.g., CPA or enrolled agent).
- **Large employers:** Generally multi-state operations, with multiple employee classifications, complex benefits program, and payroll processed by in-house integrated automation; usually has in-house staff and/or outside professional assistance in tracking government requirements.

Approximately 95 percent of the nation's 6 million employers fall into the small category, and employ a little more than half of the nation's 105 million member workforce. Due to their large numbers and lower per employer efficiency in carrying out wage reporting related tasks, these small employers carry over 90 percent of the estimated total employer burden.

A key cause of this burden is the complexity and diversity of Federal and state laws, regulations, and procedures governing wage reporting. At the detailed level, definition of wage components vary from agency to agency; there is little commonality across jurisdictions regarding reportable wage components either for withholding, tax or UI purposes; there are differences in classifications of who is an employee; schedules for reporting and payment submission vary from agency to agency; differences exist in forms content and allowable reporting media; and there is a diversity of employer identification/numbering systems. Compounding this interjurisdictional complexity, it is estimated that annually there are in excess of 400 changes in wage related laws and regulations (not counting items like routine changes in rate tables) which must be tracked and accommodated in manual and automated procedures used by employers to comply with government requirements. These changes, when retroactive, create particular difficulty especially for the small essentially non-automated employer, or when data heretofore not maintained in manual or automated records is required. Addressing complexity reduction and providing employers assistance in dealing with complexity plays a key role in achieving significant reduction in employer burden.

NEEDS OF FEDERAL AND STATE AGENCIES

Wage related taxes and payments, and associated wage data play a major role in the missions of IRS, SSA, state revenue agencies, SESAs, and indirectly through the states, DOL's Employment and Training Administration (ETA) and the Bureau of Labor Statistics (BLS).

IRS handles registration of employers for tax purposes at the Federal level, and collects most of the Federal government's revenue through wage withholdings, FICA, FUTA and Medicare taxes, all of which are computed based on wages paid. In addition, the IRS uses individual wage data collected by SSA and, through specific data sharing agreements, by states for a variety of compliance programs. In carrying out these functions, IRS processes quarterly (Forms 941 and 942) and annual (Forms 940 and 943) employment related tax returns, and periodic payments from employers. IRS processes all employment-related returns within about 60 days of receipt, all checks are deposited within 24 hours of receipt, and Federal Tax Deposit coupons are processed within 2 days of receipt.

Compliance programs carried out by IRS include the individual taxpayer underreporter and various non-filer programs, a questionable refund program, the Combined Annual Wage Reconciliation Program (CAWR), and various returns and payments collection programs, among others. In carrying out these programs IRS needs its own data and data processed by SSA from both W-2s and W-3s. In-house data are used to identify late filers, non-filers and balance due cases for collection activities. In addition, IRS uses a payment alert system to identify potential problem situations for early intervention. Completed data from SSA are usually available to IRS about six months after the close of the Form 1040 filing season. IRS spends the next six months analyzing these and other information returns data and classifying potential cases for examination. IRS program plans call for significant acceleration of these W-2 wage data related compliance programs: requiring employer filing of W-2s by the end of January and completion of W-2 processing within 60 days of filing. The results of some of IRS' compliance activities are made available to state revenue agencies through specific data sharing agreements.

SSA administers the nation's retirement, disability, survivors benefits, and supplemental security income programs, and supports the administration of the Medicare system. In carrying out its mission SSA must maintain a highly accurate and complete picture of individual wages in its Earnings Master File. Due to the nature of its programs, these data must be maintained often in excess of 50 years. Thus, extensive effort is put into up-front quality assurance, and accurate posting of W-2 wage data. Currently, SSA processes 70 percent of reported earnings within 6 months of the end of the tax year, and the remainder before the end of September. Correcting of problem cases is continued as long as practical. SSA estimates that its present Earnings Master File data are at least 99.2 percent accurate, and has program goals to improve upon this level. Starting this decade, SSA will be sending annual Personal Earnings and Benefits Estimate Statements to all registered individuals. Responses to these statements will further improve the accuracy of SSA's data.

Presently, SSA carries out several reconciliation programs in conjunction with IRS. SSA needs quarterly and annual data from employer tax returns to both manage its trust funds and to compare with data submitted on Forms W-3. In addition, SSA requires data from state UI agencies, and other data from state and local agencies, to verify eligibility for certain of its benefits programs.

Within DOL, the Unemployment Insurance Service (UIS) monitors the activities and performance of the SESAs, and manages the state unemployment trust funds. In carrying out this role, UIS needs summary weekly, monthly, quarterly and annual data provided by the states on unemployment status, claims filed, benefits paid, and related operational activities. Also within DOL, the Bureau of Labor Statistics analyzes and publishes periodic data on National employment collected through the SESAs. These statistical data are used by other Federal and state agencies in administering their respective programs, as well as by the business and research communities.

The state revenue agencies carry out tax administration programs which in most cases are similar to the IRS program. Employer registration for state tax purposes is usually carried out by the state revenue agency, though in some states this may be handled by a single point of contact for all state agencies with which an employer must do business. Usually the registration system requires the Federal Employer Identification Number (EIN), however, some states maintain their own numbering system. Various levels of informational assistance is provided to employers to help them comply with the states' tax laws.

The state revenue agencies process quarterly and annual employment tax returns and related payments. In some cases payment processing is carried out through lockbox operations under contract to financial institutions. Key entry of tax return information may be carried out in-house or under contract. Tax accounts are maintained in stand alone or shared computer systems. A few states have combined some aspects of the processing of UI returns and payments with revenue-related returns and payments. In addition, some states operate a system of combined payment processing in which a single payment coupon is used to allocate payments among various wage- and non-wage-related taxes. W-2s or the state equivalent, are processed by the state revenue agencies and used for a variety of compliance programs. In addition, through agreements with IRS and other intra- and inter-state agencies some degree of data sharing exists to support tax compliance.

The SESAs administer the state level unemployment programs. In most states, the employer UI registration process is separate from registration with the revenue agency. A separate numbering system is used, though a cross reference to the Federal Taxpayer Identification Number (TIN) is maintained for FUTA certification and other purposes. The SESAs process quarterly employer UI contribution reports and quarterly payments, as well as quarterly wage records for each employed individual. The latter are required in most states to determine monetary eligibility for unemployment benefits, and, as such these wage records are processed within 60 days of submission. (In three states employers are contacted at the time a claim is filed to determine monetary eligibility). Due to the low utilization of these wage records, most states put little emphasis into assuring their accuracy at the time of submission. Employer contribution tax rates are employer specific, predicated on an employers past unemployment history.

Harmonization of laws definition and procedures	Level 1	Level 2	Level 3
Filing periods and due dates			See note
Filing procedures			See note
Forms, formats and media			See note
Unified numbering systems			
Data definitions			
Wage components			
Definition of reportable wage			
Worker classification			
Information processed			
Federal employer wage tax			
Federal employee withholding			
State employer wage tax			
State employee withholding			
UI contributions			
UI employee wage records			
Payments processed			
Federal tax and withholdings			
State tax and withholdings			
UI tax			
Other state taxes	Optional	Optional	

Note: Level 3 scope is limited to processing of
Federal employer tax data, and
Federal and state W-2 data

Figure ES-1
Scope of WRSP for Each Level

limited, focusing on procedural, schedule, and forms and filing media alignment. Level 3 limits harmonization efforts to assuring facility in unified processing of Federal and state W-2s.

With respect to type of forms and payments processed, Levels 1 and 2 are the same and cover the full potential spectrum of WRSP. These two levels also provide an option for processing other employer tax payments as is presently done in some states. Level 3 is limited to processing of Federal and state data on W-2s, as well as Federal employer tax returns.

The functionality of each of the levels is depicted in Figure ES-2. To provide employers aid in deal with the complexity of laws, regulations and procedures, STAWRS will provide various employer services. Levels 1 and 2 provide for single coordinated employer registration, the ability of employers to validate that an SSN is correct prior to filing, extensive training programs with proactive outreach, and materials targeted to specific employer groups (e.g., start-up businesses and non-english speaking owners). These levels also provide one-stop telephone assistance to employers for both technical support and issues related to an employer's own filings and payments. In addition, Level 1 provides an employer the ability to register the hiring of an individual, a feature that will allow further customization of filing packages sent to employers, and that will reduce SSN errors. Reporting fact of employment is now required by at least one state. In Level 3, these employer services are limited to SSN validation by the employer.

All three levels provide for preparation and distribution of STAWRS submission packages for both returns information and payment. STAWRS will provide for multi-media submissions, including paper forms, magnetic and electronic files, tele-filing for small employers (using touch-tone phone and voice response units) and personal computer based online data entry screens. Emphasis will be placed on various modes of electronic filing with rapid validation of information received. Levels 1 and 2 also provide for customization of submission packages, and for payments to be submitted via electronic funds transfer, credit card, and paper checks.

STAWRS' returns and payments processing functions are similar to those currently carried out by most agencies. All three levels provide front-end functions such as mail processing, data capture, data editing and perfection, and submission archiving. In addition, Levels 1 and 2 provide for remittance processing, storage of data in WRSP data stores, unpostable resolution (including employer contact), processing of employer generated amendments, and update of STAWRS data stores based on agency generated adjustments. In Level 3, STAWRS processes returns through the data editing and perfection steps, checking and correcting entity information only to the extent it can be accomplished without employer contact. Remittances are not processes by STAWRS in Level 3.

Employer services	Level 1	Level 2	Level 3
Employer registration			
SSN validation			
Fact of employment			
Employer training			
Employer assistance technical			
Employer assistance account			
Submission processing			
Multi-media submission packages			
Package customization			
Package submission and distribution			
Returns and payments processing			
Mail processing			
Remittance processing			
Data capture			
Data editing and perfection			
Submission archiving			
Data storage			
Unpostable resolution			
Adjustment/amendment processing			
Logical data stores			
Employer entity			
Employee entity			
Employer tax liability			
Employer tax payments			
Employer UI liability			
Employer UI payments			
Employee wages, taxes & withholding			
Employee UI wages			
Claims and compliance support			
Employer tax compliance			
Employer UI compliance			
Employee tax compliance			
SSA claims			
UI claims			

Figure ES-2
 Functionality of STAWRS for Each Level

Data needed to carry out STAWRS functions are maintained for each level of implementation. Eight major data stores are identified in Figure ES-2. Levels 1 and 2 require that STAWRS maintain, or have access to, all eight of these data stores, whereas Level 3 requires only employer and employee entity data.

It is envisioned that STAWRS staff will not directly carry out any claims processing or compliance-related functions. With appropriate, security, privacy assurance, and disclosure prevention, however, data maintained by STAWRS in Level 1 and 2 implementations would be available to participating agencies for their claims processing and compliance activities. For these levels, STAWRS would provide analysis services, batch data distribution, and online access to a specific entity's information. In Level 3, data are distributed to participating agencies, and no compliance or claims processing support is provided.

For the purpose of estimating the economic feasibility of STAWRS, technical architectures have been developed for each of the three alternative levels of implementation. These architectures are site independent, and consist of four classes of facilities.

- User service facility: Consisting of an employer advice, service and education center; training development center; user agency service center, and electronic service system.
- Submission processing facility: Consisting of a receipt and control center, electronic filing system, optical and magnetic filing system, paper submission processing system, payment processing system, and submission archiving system.
- Data management facility: Consisting of a communications and security system, master data system and STAWRS data stores, automated information distribution system, statistics and reporting system, revenue accounting system, administrative system, submission package preparation system, and printing system.
- Support facility: Consisting of a master reference system, telecommunication management center, software development center and product distribution center.

STAWRS Levels 1 and 2 require this complete architecture at about the same capacity and equipment sizing. Level 3 may operate with scaled down versions of most of these facilities, systems and centers, and without the payment processing system, the revenue accounting system, the training development center, and the statistical reporting system.

INITIAL ECONOMIC ANALYSIS OF WRSP LEVELS

As indicated in Table ES-1, all three WRSP levels produce significant benefits, positive net value (benefits less costs), early economic break-even, and benefit cost ratios of greater than 1.

WRSP benefits are computed as the sum of estimated employer burden reduction, plus government savings associated with reductions from current functional operations, minus STAWRS functional operations costs. As depicted in Figure ES-3, the largest portion of these benefits accrue to the employer. Due primarily to their larger numbers, their higher costs per employee, and the greater opportunities for burden reduction, the small employer benefits most from this burden reduction, on the order of 90 percent of the total. Nearly half of the approximately \$13 billion employee benefit associated with Level 1 is attributable to reduction in complexity associated with harmonization of wage codes.

Functional operations included in government cost reduction and STAWRS are primarily those associated with providing employer assistance, preparation and distribution of submission packages, processing of returns and remittances, and supporting participating agency use of STAWRS. A major part of these costs in Levels 1 and 2 are associated with providing one-stop employer technical and account related assistance.

Estimated government costs saving to each of the Federal agencies, the state revenue agencies and SESAs, along with costs of STAWRS operations are shown in Table ES-2. Without a cost allocation formula, it is not possible at this time to estimate the net government benefit to each participating agency or agency group, an issue discussed later in this summary.

In addition to these quantifiable benefits, Levels 1 and 2 of WRSP, and to a significantly lesser extent, Level 3, have the potential of reducing barriers to formation of new business and to multistate/multisite expansion of business. They also provide participating agencies with various means to improve existing claims processing and compliance programs. Among the latter are the potential for more timely and accurate wage data for: initial claims processing and entitlement program eligibility tracking; non-filer, underreporter and erroneous refund programs; improved employer withholdings reconciliation; and ability to locate statutory debtors (e.g., delinquent child support providers).

For each of the three levels of WRSP, the estimated costs previously shown in Table ES-1, are split approximately evenly between the government and employers. Government costs include system acquisition, hardware and software operations and maintenance, and transition. Employer costs are primarily transition costs associated with learning about new WRSP procedures and modifying existing manual and automated systems used in complying with government requirements.

Table ES-1
Summary of Initial Economic Analysis Results
 (Benefits, Costs, and Net Value are in Constant 1992 Dollars,
 Benefit Cost Ratio Based on Discounted Present Value Dollars)

	Level 1	Level 2	Level 3
Benefits	15.1	8.2	2.2
Costs	2.2	2.2	0.8
Net value	12.9	6.0	1.4
Economic break-even year	2000	2001	2000
Benefit cost ratio	5.0	2.7	2.0

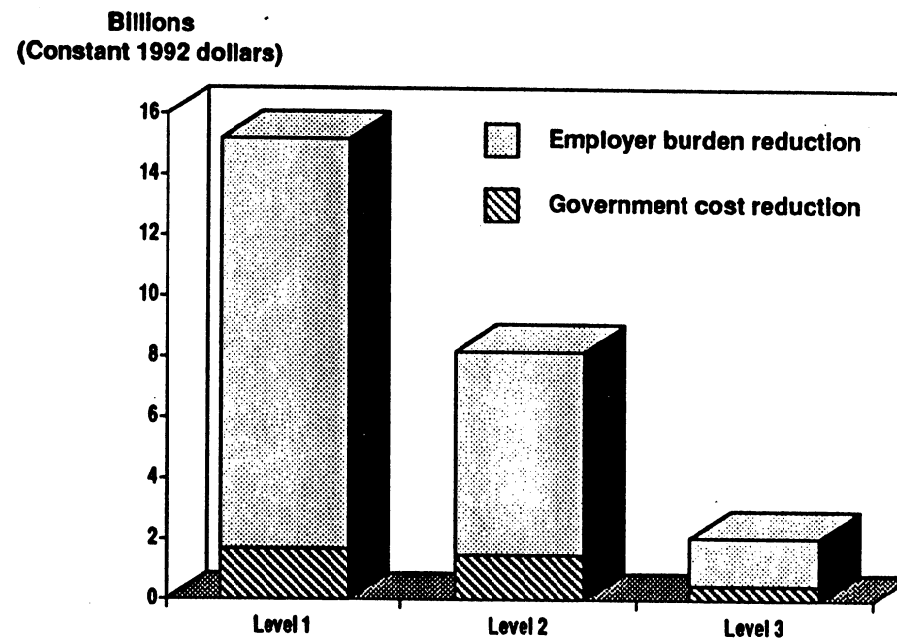


Figure ES-3
Estimated WRSP Benefits

Table ES-2
Life Cycle Government Cost Reduction
(Millions of constant 1992 dollars)

	Level 1	Level 2	Level 3
Operational costs reduction			
Federal	1040	1040	930
State revenue agencies	490	490	230
State employment security agencies	1550	1550	0
STAWRS operations	1430	1560	360
Net government cost reduction	1650	1520	530

Benefits and costs are sensitive to level of state participation in WRSP. Table ES-3 indicates this sensitivity in terms of changes in net value as a function of less than full state participation.

INSTITUTIONAL, LEGAL, AND REGULATORY ISSUES THAT MAY IMPACT WRSP IMPLEMENTATION

The previously identified government agencies and their representative organizations that have been participating in the WRSP feasibility study today have been engaging in open cooperative dialogue regarding all factors that may ultimately impact WRSP implementation. Each has indicated that in today's economic climate they must seek ways of making government more effective and efficient. The continuation of this level of cooperation, and viewing WRSP as a cooperative Federal/state venture is critical to its eventual success.

Assuring that WRSP is responsive to the needs of all agency participants and maintaining a degree of control over mission critical operations has been an important issue to all government agencies contacted during Phase I. The selection of a management structure for WRSP, which could range from management by one or more Federal agencies, to a federation of participating Federal and state agencies, to a semi-autonomous public corporation (similar to the U.S. Postal Service) are all options which should be considered.

Implementation of WRSP will require review and possibly modification of many Federal and state statutes and regulations. Current Federal and state laws governing wage tax administration, and associated entitlement and compliance programs not only vary by jurisdiction, but are scattered throughout the codes governing each participating governmental entity. This situation makes it difficult for Federal and state agencies to easily and clearly understand what they are signing up to when deciding whether or not to participate in WRSP. To ameliorate this problem it is suggested that omnibus legislation be drafted which would cover in one place all matters of concern to wage reporting simplification. Such a process may take some time to complete. Initiation of early STAWRS functionality may begin in parallel. However, to simulate maximum participation and gain the maximum benefit from WRSP, such a legislative initiative is warranted.

Organizationally and institutionally, implementation of WRSP will have to address several compliance and cost sharing issues, as well as decisions regarding who will supply certain STAWRS services. Returns submitted to STAWRS, for example, will no longer be IRS returns or state W-2s, but will be STAWRS returns with information required by many agencies. In order to maintain a focus on employer burden and government cost reduction, and given that WRSP will not directly carry out compliance functions, cooperative arrangements may be needed to secure delinquent returns and payments, and possibly to carry out cooperative audits and other compliance related functions. Under such cooperative programs, an equitable formula will be needed to allocate a short payment accompanying a

Table ES-3
Sensitivity of WRSP Economic Analysis to Level of State Participation
(Net value of WRSP in billions of constant 1992 dollars)

Level of Ultimate Participation	Level 1	Level 2	Level 3
Full participation	12.9	6.0	1.4
75 percent participation	9.3	4.1	.8
50 percent participation	5.6	2.3	.2

payment coupon. Similarly delinquent payments, secured by a coordinated collection activity, need to be allocated.

In addition to cooperative compliance arrangements and formulas for allocations of payments and collection, an equitable formula for allocation of STAWRS costs to all agency participants is required. Such a formula must be developed not only for operations costs, but also to determine how STAWRS acquisition and development costs will be financed.

Related to this cost sharing issue is the potential use of a non-governmental entity to carry out some of the STAWRS envisioned functions. In addition to costs and management control considerations, decisions along this line will depend on which aspects of STAWRS functionality, if any, are considered essential functions of government.

One key factor in employer burden reduction is the implementation of one-stop service to the employer. As it is likely to be impractical for STAWRS staff to be completely cross trained in all aspects of Federal and state laws related to wage reporting, it is envisioned that participating agencies will have a cadre of technical specialist employer assistants available through a STAWRS operated call director system to field detailed, agency specific employer queries.

The previously described STAWRS functionality is envisioned to make maximum use of modern technology for its employer and agency user interfaces. Many of the existing laws are written around paper and magnetic return submissions, and magnetic tape data exchange. Electronic filing, on-line data entry screens, PC and touch-tone data entry, and electronic funds transfer may require new legislation, regulations and procedures. A system of authentication using some combination of user id's and personal identification numbers, or more sophisticated secure digital signatures, may be needed. Improved and coordinated standards for electronic and magnetic filing will be required along with incentives for employers to use these more cost efficient approaches. In addition, modified legislation and/or standards may be required to allow for greater use of electronic funds transfer and credit card payment.

Assuring privacy, preventing unauthorized disclosure, and securing the data stored in STAWRS are imperatives for WRSP implementation. It is important to note that STAWRS is not envisioned to collect any data beyond that which is collected today; that current data sharing agreements will remain in force unless specifically modified through new legislation, regulation or inter-agency agreement; that, as today, electronic access will be limited to authorized users; and that a comprehensive policy and program controls all aspects of STAWRS security. Still the consolidation of currently distributed wage-related data (whether logically through telecommunication or physically) will raise issues of concern that must be addressed. Current laws and regulations regarding privacy and disclosure of data to be processed and/or maintained by STAWRS will have to be reviewed and aligned to meet the operational needs of the WRSP environment, while at the same time protecting the rights

of employers and individuals. Data ownership issues (the right to obtain, retain and modify data), requirements for data accuracy, and liability for erroneous or late processing must also be understood and reconciled.

To assure privacy and prevent unauthorized disclosure, it is envisioned that STAWRS will operate under a comprehensive security policy and program which: uses the latest security technology and procedures in hardware, software and telecommunication both during development and operations; addresses all aspects of access to, and dissemination of, data; provides for accountability, monitoring and audits, and enforcement and penalties for unauthorized disclosure; incorporates administrative and physical safeguards; requires periodic risk assessments and institution of risk mitigating measures; and provides protection against natural and man-made disasters.

Wage code harmonization has been previously discussed as a mechanism that will significantly reduce complexity and employer burden. Somewhat akin in concept to the Uniform Commercial Code used throughout the states, though somewhat less comprehensive in scope, wage code harmonization would address such topics as definitions, wage components, coordination of filing periods and payment schedules, unified numbering systems, and formats and media for filing. Specifically not included in a harmonization effort would be wage the base and tax rates for related Federal and state programs.

Definitional alignment would include, for example, who is an employee and who is an independent contractor, and what is meant by and included in a cafeteria plan. Harmonization would consistently define which components of remuneration constitutes reportable wage for specific classes of tax. Schedule alignment would provide for consistency and comparability of data within reporting periods, and further reduce confusion over payment schedules. In addition to reducing employer burden, such harmonization of wage codes will significantly improve the implementability of STAWRS.

Implementing WRSP will be as much, if not more, an institutional, legal and regulatory issue as a technical one. To address the former, a strategic plan is needed for involving all of the key WRSP stakeholders, identifying major components of required omnibus legislation, and formulation an approach to obtain buy-in by the participating agencies and governments. In parallel with the formation of such a plan, it is recommended that the Federal government begin an effort to align its laws and regulations as an example for a more widespread effort.

SECTION 1

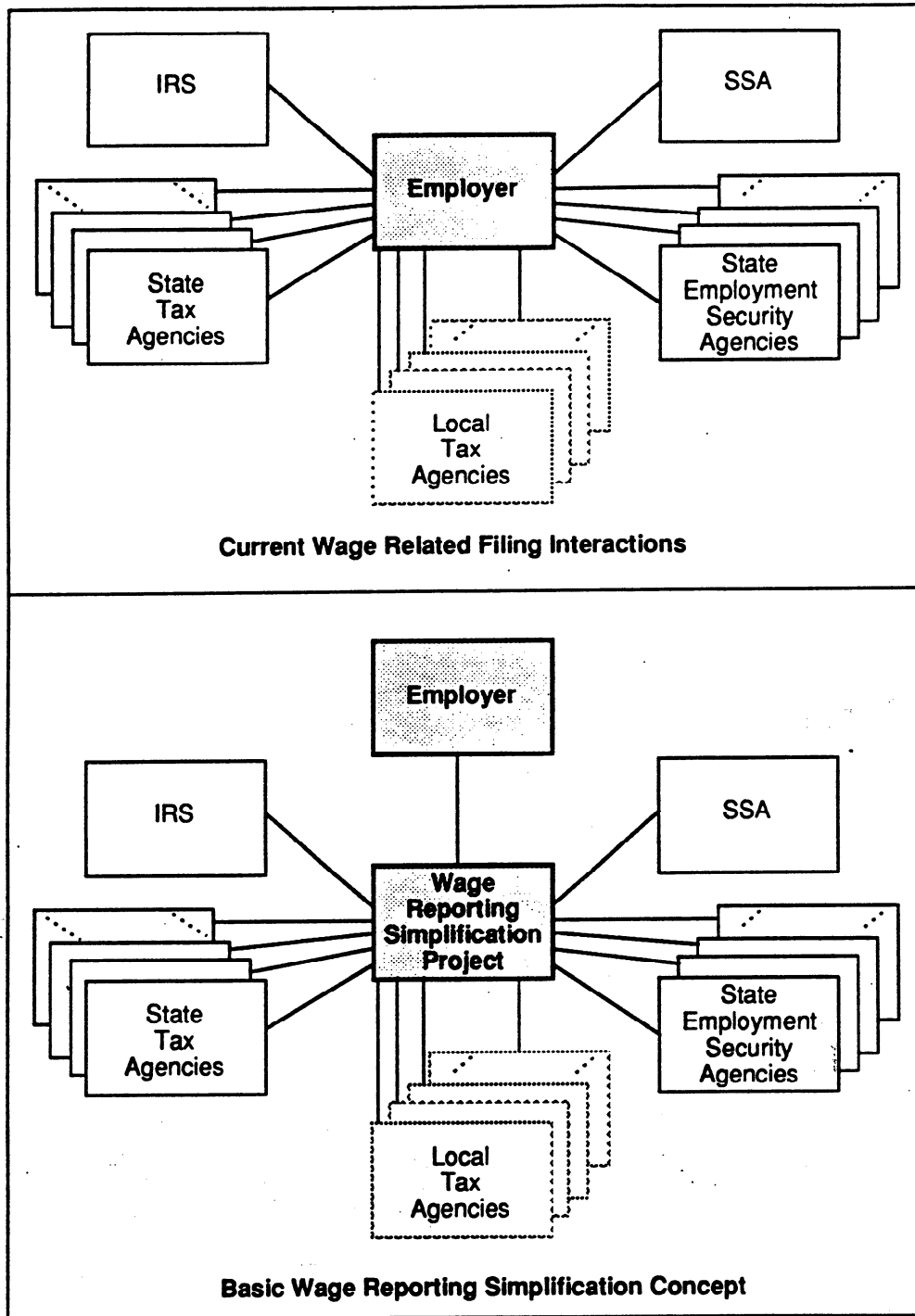
INTRODUCTION

The current wage and payroll tax reporting system requires employers to provide to the Federal Government annual Wage and Tax Statements (W-2), Transmittals of Income and Tax Statements (W-3), Employer's Annual Federal Unemployment (FUTA) Tax Returns (Form 940), Employer's Quarterly Federal Tax Returns (Forms 941 and 942), Employer's Annual Tax Return for Agricultural Employees (Form 943), and Federal Tax Deposits (FTDs). Employers are also required to submit to states wage-related tax forms and payments, employee-level annual wage and tax statements (the state W-2), unemployment insurance (UI) contribution forms and payments, and UI employee quarterly wage records. In some cases, wage-related information and taxes are also required at the local government level. In many instances, the information contained in these submissions overlaps, and differences in filing requirements, definitions, and calculations make current wage-related reporting complex and expensive for the employer community.

A simplified wage reporting system has been advocated for several years by payroll tax professionals, Federal agencies, and other interested parties. Under such a system, involved Federal and state agencies would jointly develop an integrated reporting approach. One approach to simplifying currently complex government interactions is to have employers file employment- and wage-related information with a single processing entity; that entity would, in turn, be responsible for providing the data to Federal, state, and local agencies for which the submitted information was intended (see Figure 1-1). Implementation of such a concept would, by necessity, involve not only consideration of where employers would file required submissions, but also how such a concept would change employers filing burden; how participating agencies would work together and better coordinate filing requirements; what the costs and benefits are of such a concept; and what institutional, legal, and regulatory issues need to be addressed if such a concept is to be implemented. This feasibility study, the first phase of which is reported on in this document, addresses many of these issues, and provides a starting point for analysis and decision making related to implementation of wage reporting simplification.

1.1 GENESIS OF THE WAGE REPORTING SIMPLIFICATION PROJECT

The concept of wage reporting simplification has been the subject of active discussions both inside and outside the government for several years (see Figure 1-2). Wage reporting simplification was discussed at the 1988 and 1989 meetings of the Federation of Tax Administrators (FTA) and the Internal Revenue Service (IRS) Federal/State Coordinating



**Figure 1-1
Simplified Wage Reporting**

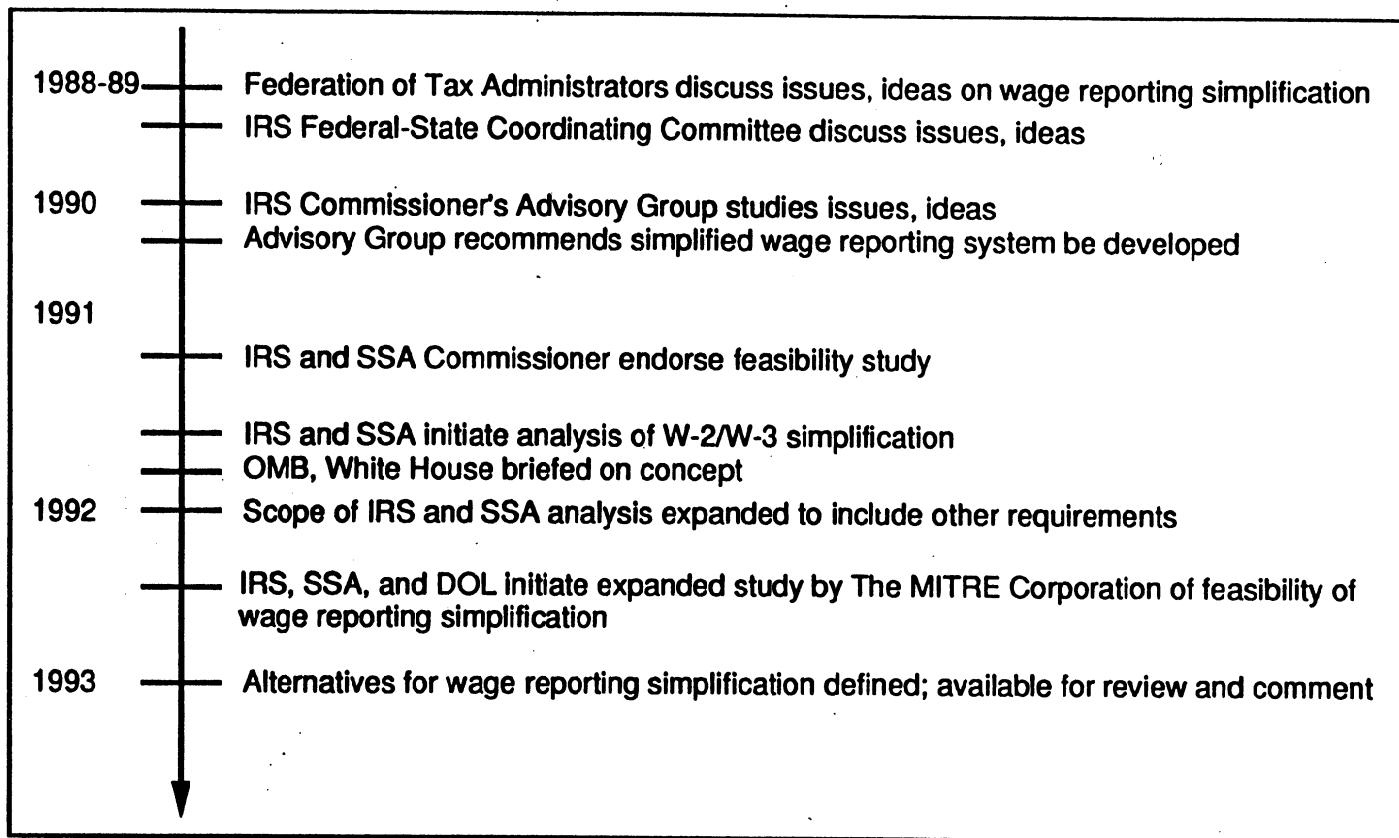


Figure 1-2
Genesis of the Wage Reporting Simplification Project

Committee. The concept was further advanced when the Automation Subcommittee of the IRS Commissioner's Advisory Group (CAG) studied it as part of its agenda in 1990. In December 1990, the CAG Automation Subcommittee recommended to the Commissioner that a simplified wage reporting system be developed.

The Automation Subcommittee report was endorsed by former IRS Commissioner Fred Goldberg and discussed at the IRS/Social Security Administration (SSA) Executive Policy Council. Based on these discussions, former IRS Commissioner Goldberg and former SSA Commissioner Gwendolyn King endorsed an examination of the feasibility, operation, and cost of a simplified wage reporting system. Former IRS Commissioner Goldberg also called this initiative to the attention of the White House and Office of Management and Budget (OMB). Subsequently, this initiative was included in the President's fiscal year 1993 budget.

At the request of the IRS/SSA Executive Policy Board, IRS and SSA staff initiated an analysis in the fall of 1991 to examine the feasibility and merits of implementing a simplified wage reporting system that would encompass the payroll tax reporting requirements associated with W-2 and W-3 data. In February 1992, the preliminary results of the analysis were presented and it was decided to broaden the scope of the effort to include an examination of the reporting and processing associated with IRS Forms 940, 941, 942, and 943, as well as UI and state-level payroll-related tax requirements, and related Federal and state tax payments. This broader effort has come to be known as the Wage Reporting Simplification Project (WRSP). In July 1992, the IRS/SSA Policy Board, with the Department of Labor (DOL), initiated this feasibility study of the WRSP concept. The MITRE Corporation was selected to support this effort.

1.2 GOAL OF THE WAGE REPORTING SIMPLIFICATION PROJECT

The overall goal of WRSP is to reduce the burden on employers, while maintaining or improving the effectiveness of government operations (see Figure 1-3). Employer burden is defined primarily in terms of reducing the complexity, cost, and time with which employers are confronted in responding to employment tax-related government requirements. In the context of this feasibility study, government operations consist of providing employment tax-related assistance to employers, processing tax returns and employee-level wage returns/reports, processing tax payments, and providing information needed for claims processing and compliance-related activities.

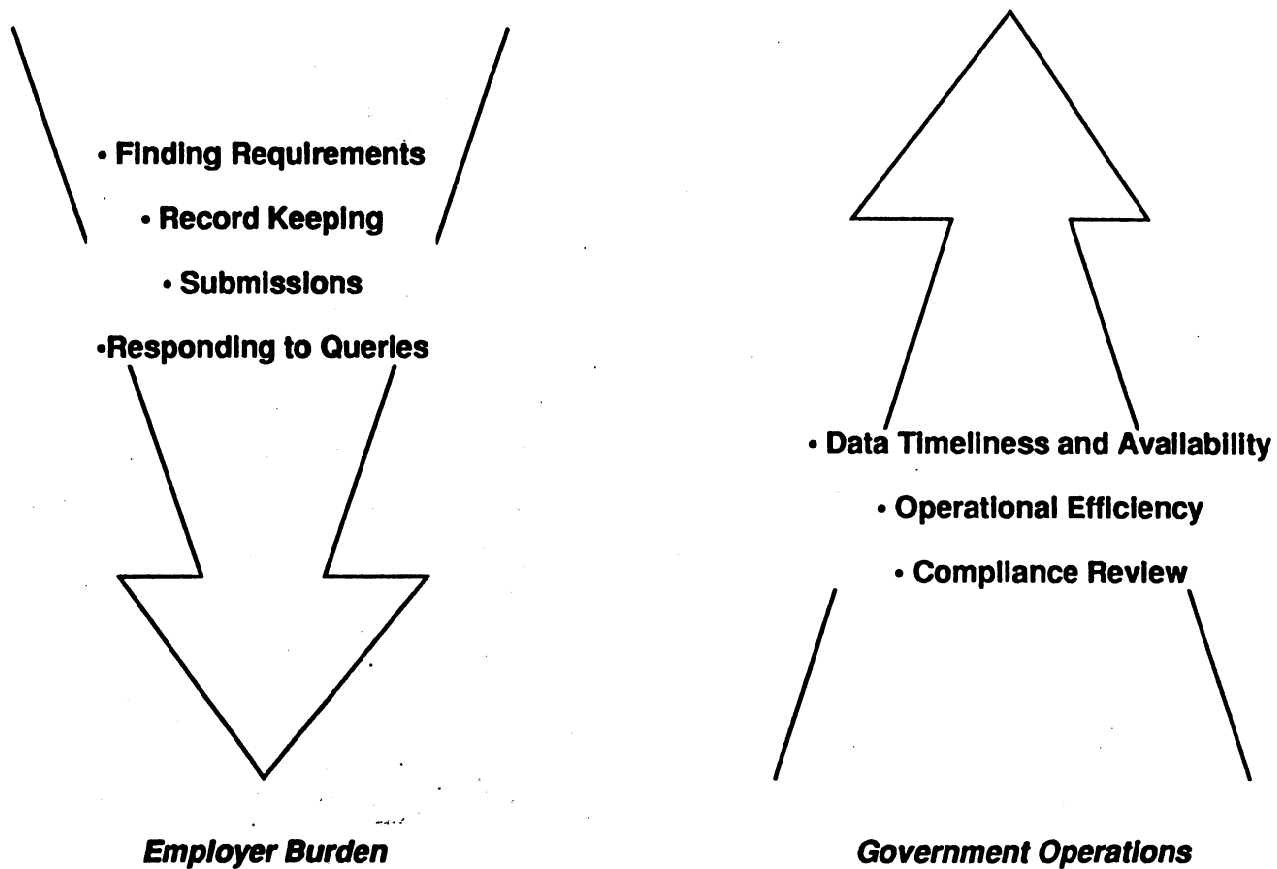


Figure 1-3
Objectives of WRSP

SECTION 2

THE FEASIBILITY STUDY

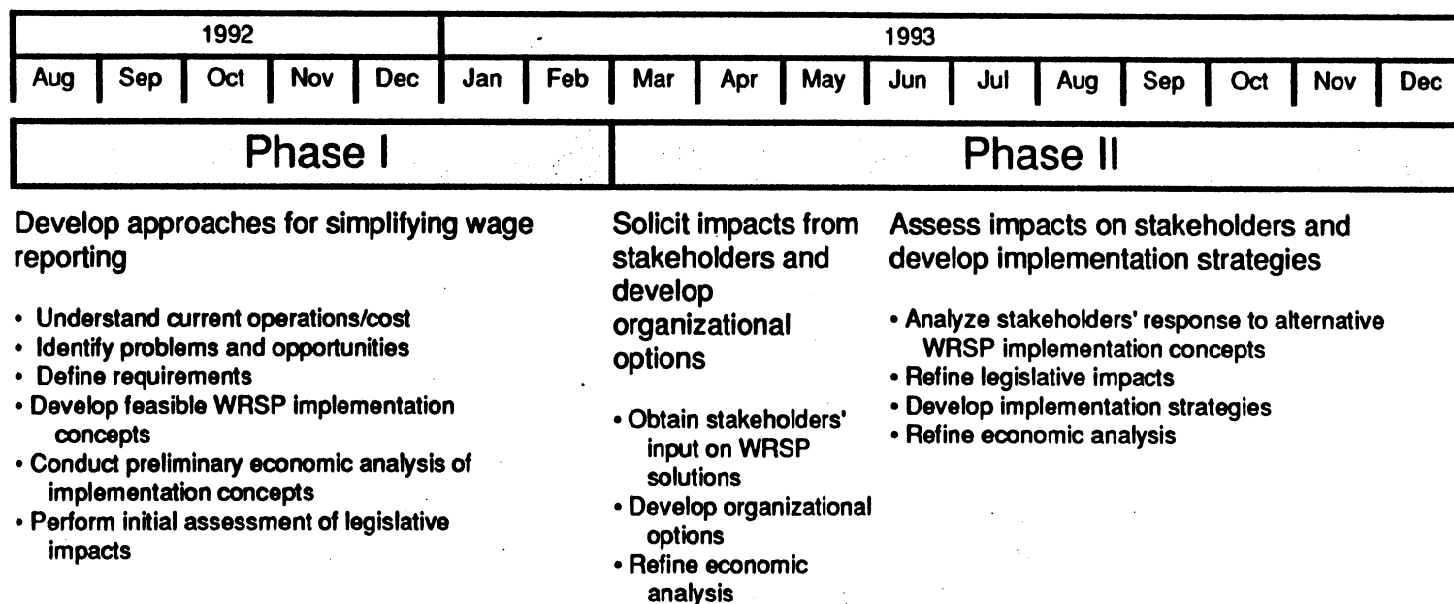
The feasibility study, by applying a systems engineering approach, is intended to assess potential changes to employer burden and government operations resulting from implementation of alternative WRSP concepts.

2.1 STUDY SCOPE

The study has been divided into two phases as shown in Figure 2-1. The first of these phases has been completed. Phase II is expected to be completed by the end of 1993. This report presents the results of Phase I only.

In Phase I, the study:

- Analyzed and document at a high level the current wage and tax reporting systems
- Identified the major costs associated with the current systems which will be used as a baseline to compare against new alternative concepts
- Identified the problems and opportunities associated with the current wage and tax reporting systems
- Defined the universe of potential WRSP requirements that could be met by a redesigned system
- Defined three levels of requirements with varying degrees of scope and functionality
- Defined three conceptual technical architectures which can feasibly provide the functionality defined in the levels of requirements
- Determine the costs and benefits of the three technical architectures
- Identified legislative and regulatory issues associated with implementation of the WRSP requirements



**Figure 2-1
WRSP Feasibility Study Overview**

The feasibility analysis carried out to date has made no specific assumptions regarding the allocation of WRSP functionality to specific Federal and/or state agencies. Such analysis is to be part of Phase II. More specifically, no assumptions have been made with respect to the Federal government providing WRSP functionality. Preliminary discussion of WRSP management and operational allocation issues is presented in Section 6.1 of this report.

The three implementation WRSP concepts represent a broad range of possible WRSP scope, functionality, and systems defined for the purpose of assessing WRSP feasibility. They do not represent specific designs for program implementation. It is most likely that WRSP, if implemented, will fall somewhere within the range of the three concepts presented.

Phase II will focus on stakeholder review of the Phase I effort and analysis of how WRSP functionality may be delivered. In Phase II, the following tasks will be conducted:

- Provide the WRSP stakeholders with a report on Phase I and solicit their responses to the proposed concepts
- Develop organizational options which reflect the capacity of government agencies or third parties to deliver WRSP capabilities
- Analyze responses solicited from the states, the business community, and other affected organizations with respect to impacts on their activities, and their receptivity to each alternative WRSP concept
- Based on the selection of one technical architecture, develop alternative implementation strategies for achieving the selected WRSP capabilities

Accomplishment of all of these tasks will complete the WRSP feasibility analysis.

2.2 OBJECTIVE, AUDIENCE, AND ORGANIZATION OF THIS DOCUMENT

The objective of this document is to summarize the results of Phase I as a basis for soliciting comment from the major WRSP stakeholders, regarding basic WRSP concepts. These stakeholders include:

- The employer community and their representative organizations
- The service industry currently supporting employers in fulfilling wage reporting-related functions

- Federal government agencies involved in wage reporting functions (i.e., IRS, SSA, and DOL¹)
- Federal agencies currently using wage reports data
- Federal oversight agencies
- State tax agencies and their national-level association
- State employment security agencies and their national-level association
- State governors offices and their national-level association

Table 2-1 provides a list of major stakeholder representatives that have been participating in feasibility efforts to date. These agencies and organizations have provided data used in the analyses carried out to date (e.g., data on the employer's costs of responding to government requirements and cost of processing submissions), reviewed draft material, and participated in meetings on early study results.

In addition to these governmental and business-related stakeholders, WRSP may have an impact on individual taxpayers, SSA beneficiaries, UI claimants, and participants in other government programs. Though no specific representative of these stakeholders has participated to date in the feasibility study, several anticipated key concerns of these groups have been addressed in defining WRSP requirements and identification of related institutional, legal, and regulatory issues. Among the potential impacts, implementation of WRSP may be expected to improve the accuracy of reported wages and withheld taxes and to provide accurate and timely data to entitlement agencies. The study also addresses issues related to assuring privacy and preventing unauthorized disclosure of sensitive employment and wage information.

In addition to the stakeholders listed above, the concepts embodied in WRSP have applicability to other government agencies as well. Although these agencies are not directly addressed in this feasibility study, they include the numerous local governments that have some form of wage-based tax and that currently administer their programs either independent of or in conjunction with state-level programs. Additional interested parties include the

¹ DOL does not directly collect wage-related data from employers. However, DOL provides Federal oversight of state employment security agencies, establishes certain standards for these programs, and specifies the statistical data derived from employer submissions that the states must report to DOL.

**Table 2-1
Major WRSP Stakeholders**

Federal Government	State Government			Employers/Agents
IRS 1, 2, 3 SSA 1, 2, 3 DOL - Employment and Training Administration 1, 3 DOL - Bureau of Labor Statistics 1,3 OMB 1,3 Small Business Administration	Wage Tax	Unemployment Insurance	Governors	<u>Employers</u> National Association of Self Employed National Federation of Independent Business American Payroll Association 1, 2, 3 Bureau of National Affairs 1 American Society of Payroll Managers <u>Agents</u> American Institute of Certified Public Accountants Tax Executives Institute National Association of Enrolled Agents 1
	Federation of Tax Administrators 1 Selected States: California 1, 2 Michigan 1, 2 New York 1, 2 South Carolina 1, 2 Virginia 1, 2 West Virginia 1,2	Interstate Conference of Employment Security Agencies 1, 3 Selected States: California 1, 2 Maryland 1, 2 Michigan 1, 2 New York 1, 2 South Carolina 1, 2 Washington 1, 2 West Virginia 1,2	National Governors' Association 3	

Legend

- 1 Supplied data for study
- 2 Subject of site visits
- 3 Provided comments on draft material

Note: All stakeholders have participated in WRSP meetings.

Federal and state agencies that rely on the employment and wage-related data currently collected by IRS, SSA, and the state-level revenue and UI agencies for the purposes of statistical analysis and the administration of entitlement programs.

In addition to those stakeholders that have been directly participating in the feasibility study, review and comment on WRSP concepts by these additional stakeholders and their representatives will contribute greatly to ultimate program success.

The four major sections that comprise the body of this study address the following issues. Section 3 presents the major study findings which set the stage for the formulation of the WRSP requirements and the definition of the WRSP design alternatives. These findings are based on a review of current employer, agent, and governmental activities. Section 4 describes each of the alternative WRSP concepts with respect to concepts of operation -- as defined from both an employer and government perspective, the filing requirements, and the technical systems needed to achieve implementation of the concepts. Section 5 contains the results of the preliminary Phase I benefit/cost analysis that was conducted for each of the three concepts. Finally, Section 6 presents a preliminary view of the institutional, legal, and regulatory issues that may have an affect on or be affected by the implementation of WRSP.

SECTION 3

FINDINGS WHICH GUIDE THE WAGE REPORTING SIMPLIFICATION PROJECT CONCEPT DEVELOPMENT

Employer wage reporting-related activities and costs, and current and near-term planned activities and associated costs of the government agencies administering related programs have provided the basis upon which the alternative WRSP concepts are formulated.

Figure 3-1 depicts the current wage reporting environment. Employers today must interact with IRS and SSA at the Federal level, and one or more state employment security agencies and state revenue agencies, among others. The nature of these employer/agency interactions is not limited to filing forms and payments, but also includes initial registration, determining filing and related record keeping requirements, obtaining technical and account-related information and assistance, and responding to government initiated inquiries and notices. The complexity of these interactions, which are described extensively in this section, has been the primary factor in formulation of the alternative WRSP concepts used in this feasibility study.

Extensive interactions also occur among the various government agencies. To administer the respective programs, IRS and SSA must exchange information on employer tax liabilities, and on deposits to SSA trust funds. W-2 information filed with SSA is required by IRS for individual income tax compliance programs. To maintain mutually high levels of taxpayer compliance, the results of certain IRS and state-level compliance activities are shared among these agencies. Program management information and employer-level data collected by the State Employment Security Agencies (SESAs) are respectively shared with DOL's Employment and Training Administration and the Bureau of Labor Statistics (BLS). In addition, statistical summary data from IRS, SSA, and DOL are used by other Federal agencies in administration of DOL programs. (In many cases, employers may have direct data submissions with these other Federal agencies, some of which may contain employment information that is not wage related. This feasibility study, to date, has not addressed these employer requirements.)

Interactions also take place among state revenue and employment security agencies, both inter- and intra-state. Such interactions include, among others, identification of employers doing business within a state, fact of employment, and the results of compliance activities. In most states, data sharing takes place to some degree to assure employer compliance with state tax laws. For tax administration purposes, data sharing among states is dependent upon specific interstate compacts or agreements. For employment security agencies, sharing of

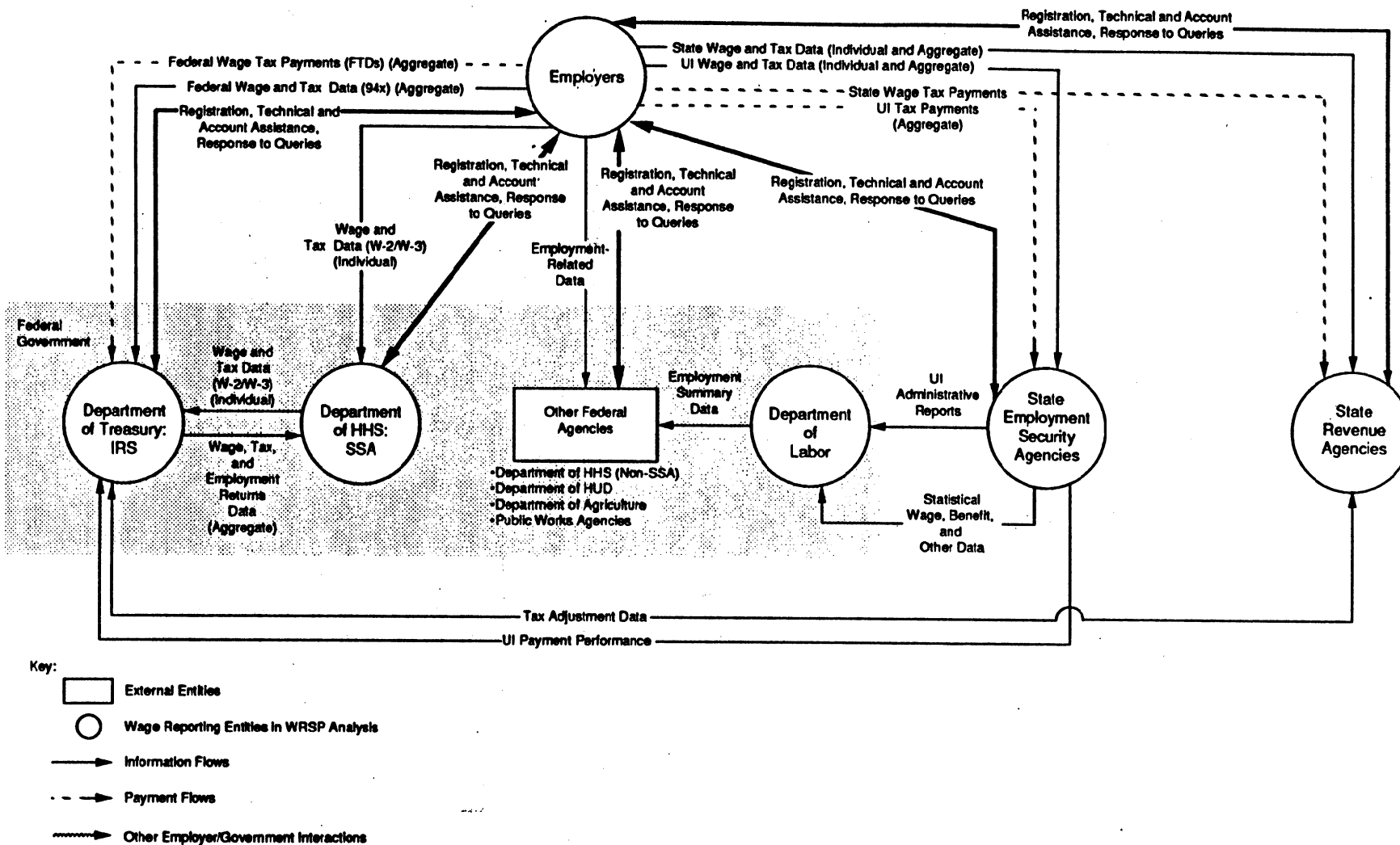


Figure 3-1
Current Wage and Tax Reporting Environment

wage record data among states is routine for the purpose of establishing benefit eligibility, whereas data sharing for employer compliance programs is a function of specific inter-state agreements.

These employer and governmental activities are further delineated in the following sections. In some cases, near-term plans (e.g., accelerated processing of W-2s) that may impact WRSP are also described.

3.1 MAJOR AREAS OF EMPLOYER BURDEN

The employer community is the source of most of the data used by revenue and entitlement agencies at the Federal and state level in administration of wage-related taxes and entitlement programs. These programs by their nature place significant burden on this employer community. Little detailed data, however, seems to exist to quantify, in a statistically significant sense, the extent of this burden. No surveys have been carried out to date as part of the WRSP effort to improve on this situation. Given these limitations, the feasibility study has relied on existing written reports and discussions, interviews, and data provided by a variety of corporate payroll professionals, tax and accounting practitioners, and material published by the Small Business Administration (SBA), the National Federation of Independent Businesses (NFIB), and the Bureau of National Affairs (BNA), among others, as its sources for characterizing the employer community, estimating current employer burden, and identifying approaches for burden reduction. In aggregate, the cost to the employer community for activities related to Federal and state wage reporting and wage-related compliance is on the order of \$6 to \$9 billion per year. The sources of this burden are discussed below.

3.1.1 Burden Categories

Four burden categories have been defined to identify sets of tasks employers must carry out.

- **Tracking requirements:** This includes the tasks of finding, understanding, and implementing the provisions of wage reporting law and regulation.
- **Record keeping:** This includes the tasks associated with the processing of employment and payroll records; the generation, accumulation, and recording of data necessary to prepare required forms and coupons.
- **Preparing submissions:** This includes the tasks of actually preparing and reconciling (within the business) documents for submission to the government, including the transfer of funds by either direct payment or via a deposit program.

- Responding to government queries: This includes any tasks necessary to deal with the correspondence and notices received from government entities, including courts if it relates to employment or wage data.

In Circular E, *The Employers Tax Guide*, distributed by IRS, reporting is spoken of in the following way: "Employers must withhold, deposit, report and pay" OMB refers to the following categories of reporting burden: record keeping, learning about the law or the form, completing the form, and copying, assembling and sending the form. These activities, however, comprise only a portion of the overall employer burden. Figure 3-2 indicates which parts of the employer burden definition used in this study are accounted for by the OMB definition as required under the Federal Paperwork Reduction Act. In essence, the OMB definition pertains only to those activities which directly relate to the compliance process involving understanding the requirements, keeping proper records, and submitting the necessary forms. It excludes activities that employers are likely to engage in as a consequence of the Federal and state wage reporting requirements. Beyond simply finding and understanding the requirements, employers must also understand the impacts of regulatory change on their operations. Employers must also make tax deposits based on their wage payments as part of the wage reporting process. Finally, employers spend a considerable amount of time responding to error notices and inquiries that are generated in the wage reporting process. These activities significantly expand the scope of the employer wage reporting burden. In this analysis of the employer burden, which extends the OMB definition of the Federal burden activities to include state compliance measures as well, these indirect activities account for approximately 30 percent of the total employer burden. This feasibility study used this very broad definition of the reporting burden to assure that opportunities to alleviate employer burden are not missed in the analysis of the wage reporting alternatives.

Figure 3-3 shows the flow of activities associated with employer wage reporting and payment processing. The circles in the figure represent activities that are performed within the overall process of reporting, while the shaded rectangles represent the four burden categories. This representation simplifies the presentation of the process by condensing the reporting to government agencies into one flow, when, in fact, the flows for different agencies are only partially coincident.

When employer burden is considered from the perspective of the state and Federal agencies, the burden categories developed tend to be focused on the form preparation and submission elements. Data indicate that this is not where the bulk of the burden lies. The most significant portions of the burden are in the understanding of requirements and record keeping categories.

Any solution that reduces burden to the employer will need to take into account the costs of changing the current system, and will need to reduce the employers payroll tax research requirements. Trade associations have indicated that the most important aspect of any wage reporting program is uniformity of administration and wage definitions.

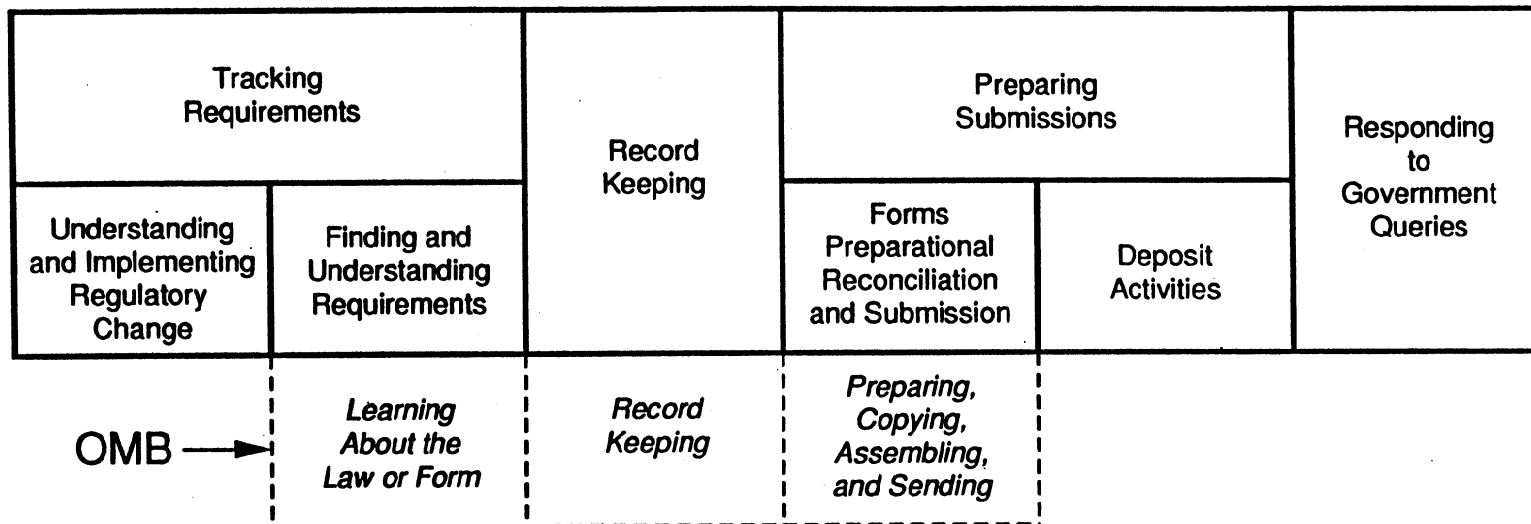


Figure 3-2
Employer Burden Definition

3.1.1.1 Tracking Requirements

The problem of addressing government requirements is twofold. The first element is a one-time expense in the initial formation of business systems for wage reporting. The new business must discover what government bodies it is responsible to, and what actions need to be taken to assure that the requirements can be met. Furthermore, a system must be designed and installed to perform these actions, using either a manual or automated process. As noted below, the rapid growth of new businesses owned by minorities, particularly those segments for whom English literacy is limited, requires special attention.

The second element of tracking requirements is part of the ongoing operations of an employer. Before an employer can begin to prepare a wage reporting or tax form, some resources must be expended. When considering the small employer who is reporting manually, this might seem to be a negligible effort, which is easily but imprecisely aggregated into the effort required to prepare the form, but interviews with employer representatives and OMB data, however, yield a different result. When considering the larger employer who uses automated payroll systems, the distinct nature of each of these activities becomes much clearer. Large firms have staff devoted entirely to understanding payroll tax reporting requirements, staff for reviewing regulatory change and determining the effect on the firms responsibilities, and staff devoted to implementing those changes. All of these resources are expended before records are kept and forms are prepared.

Finding Requirements

All employers, regardless of their size, devote considerable resources to this burden category. It includes time or money spent gathering information on real or perceived requirements. Typical activities include finding out which taxes one is responsible for, seeking information on registration and basic filing and record keeping requirements, reviewing Federal and state registers; consulting with professional bookkeepers and Certified Public Accountants (CPAs); purchasing subscriptions to and reviewing newsletters, trade publications, and other reference material; and joining and attending meetings of professional associations. Also included in this category is time spent in determining the reporting requirements for the purpose of making business policy decisions, such as whether to hire an out-of-state salesperson or to establish a new store in another state. Businesses that operate in multiple jurisdictions are more heavily burdened than those that operate in just one state; realization of this potential added burden may discourage a small business from expanding beyond state boundaries.

One of the problems faced by the small business is identifying the actions required for compliance with state and Federal wage reporting regulations. The IRS answer to the information needs of the business person about to hire employees is Circular E, *The Employers Tax Guide*. Circular E refers to Publication 937, *Business Reporting*, which is a more generic treatment of the subject, including the self-employed, sole proprietorships,

independent contractors, and members of a partnership. Together they comprise 86 pages of densely packed information. Neither of these publications makes any reference to state reporting requirements. Circular E explains its purpose as follows.

"This guide explains your tax responsibilities as an employer. It explains the requirements for withholding, depositing, reporting and paying taxes. It explains the forms you must give your employees, those your employees must give you, and those you must send to the IRS and the SSA.

Most employers must withhold, deposit, report, and pay:

- **Income tax**
- **Social security**
- **Medicare taxes**

They must also deposit, report, and pay Federal Unemployment tax (FUTA)."

As a Federal publication, Circular E or Publication 937 focuses on Federal tax requirements. As such, it does not address similar taxes which may be due to state authorities. The business person is left to perform a search for agencies that may have a claim on their wages paid or their wage information. While this search may seem trivial to those with an understanding of the state requirements, it must be remembered that the business person must determine the completeness of their search through negative information. Since today there is no cross-agency policy and/or responsibility for informing the business person of their overall Federal and state reporting requirements, the search can only be declared complete after searching for some time for additional reporting requirements without success. This problem arises in many disciplines, and it is always difficult to determine the extent of searching that is required to declare the search comprehensive and complete.

State authorities may offer some top-down information on the overall state picture. In a few states, for example, there is a centralized registration program which forwards information about a new business to the many related state taxing agencies. Usually each of the agencies separately sends information related to their specific requirements to the new employer, sometimes after lengthy delay periods. Being a Federal entity, SBA limits itself to the consideration of only Federal issues, and does not appear to offer any publications to prevent confusion on this matter. Lack of complete information can cause a kind of involuntary noncompliance. The latter may cause the failure of a small business due to the cash flow problems experienced at the time of reconciliation. To date there seems to be no readily available information on this type of occurrence. Some portion of the dunning notices sent out and legal actions pursued may, however, be indicators of this lack of complete

understanding of filing requirements. While there is an indicated willingness to comply on the part of the smaller businesses, the economies of scale inherent to the wage reporting process may prevent the small businesses from performing sufficient investigation.

While larger businesses have resolved most of the questions of reporting responsibility, they also need to devote resources to this burden activity. The higher dollar volume of their payroll justifies a larger effort to maintain strict compliance with the law.

Understanding and Implementing Regulatory Change

Changes to reporting requirements have historically been a source of significant burden to the employers, both large and small. Changes, such as the separation of the Federal Insurance Contributions Act (FICA) and Medicare reporting, cost the employers with internal, fully automated payroll departments a great deal of time and money. On the other end of the spectrum, the small employer without a service provider or internal automation is also affected by the disruption of manual systems. The employers with service providers may have been partially sheltered from this change, since they realize an economy of scale by sharing this burden with many other employers. However, such employers must still deal with the question and confusion that such changes generate. Employers are concerned that government agencies are not aware of the impact these changes have on their burden, and there is a popular perception that the changes are sometimes capricious. Periodic changes, such as changes to the tax rates, or adjustments to the social security base, are expected and do not constitute an undue portion of this burden.

Retroactive changes with short deadlines are of particular concern. The collection of the data can become problematic, as the automated systems may not have been recording the data of interest, therefore requiring manual data entry. Any change, retroactive or not, can require the re-design of the employer's wage data base, with the resulting changes requiring manual bookkeeping as well as programming costs. Changes may also require new or additional training of bookkeepers or payroll department personnel.

A hidden burden in regulation changes is the communication with and education of employees. Notifying employees of changes in advance and dealing with employee questions after the fact can be a costly proposition.

3.1.1.2 Record Keeping

This task comprises one of the activities that is traditionally associated with wage reporting burden. The employer must maintain records of employee wage, benefit, and W-4 and state equivalent information, as well as other data elements. The degree of complexity depends in part on the number and type of employee categories, the types of remuneration, and the number of jurisdictions requiring reports. Record keeping also includes the computation and recording of taxes and the amounts deposited during the submission process,

and the posting to other accounts for use in the preparation of business income tax and other financial statements. This activity includes the cost of all record keeping due to wage reporting requirements, but does not include the costs of record keeping required in the normal course of doing business.

3.1.1.3 Preparing Submissions

These tasks comprise the other activities that are traditionally associated with wage reporting burden.

Forms Preparation/Reconciliation and Form Submission

This activity represents the preparation of the form (whether it is submitted on paper or other media) and includes data retrieval from record keeping, computations, data entry, printing, media handling, and internal accounting/reconciliation for all wage reporting activities. It includes preparation of the wage-related forms defined for this study. It does not include making payments and response to government queries. Form submission burden data is collected separately to allow for consideration of the burden difference realizable by providing a single wage report option.

Deposit Activities

Making payments, the deposit activity, includes all costs associated with deposit of payroll taxes, including computation, coupon preparation, and submission costs. They do not include error resolution, reconciliation, and record keeping for the purposes of deposit.

Because of the complexity associated with multi-state reporting, each of these activities becomes dramatically more detailed in the case of the larger multi-state employer. This complexity is compounded by the large diversity in payment schedules across states and agencies of payment schedules.

3.1.1.4 Responding to Government Queries

The entire spectrum of government correspondence has not been fully investigated, but appears to fall into two categories: those notices that attempt to redress errors, real or perceived; and those inquiries that seek information about an individual employee. Responding to these error notices and inquiries (including UI claims) constitutes a burden on the employer. Unemployment authorities ask employers to verify conditions of severance when claims for benefits are made. In the three wage request states, employers must respond to UI agency inquiries with greater frequency. SSA periodically asks employers for information about individual employees to resolve discrepancies between the SSA earnings files and the employee's records. This can be particularly burdensome in the case of a former employee who has been gone for a period of years.

In responding to government queries, large employers have established relationships with contacts in both the Federal and state agencies; small employers have to work their way through the system to find someone capable of solving the problem. It was reported that, in general, states were better prepared and more responsive than IRS. The lack of a centralized account or focused responsibility within IRS delayed both error resolution and employer response to government queries.

Error Resolution

This activity comprises all responses required as a result of notifications of error sent by government agencies, as well as any errors discovered by the employers. It also includes requests for clarification and for corrections of inaccurate computation and oversights made by employers. In many cases, error resolution can be thought of as being related to finding and understanding requirements; if the requirements were understood in the first place, the error resolution step might not be an issue.

Government Query, Audit, Compliance, and Claims Processing Response

This activity includes all submissions of data to the government in response to a request which could be resolved without the business being represented if the government had the information. It does not include response to error notices. Indications are that this is not one of the major burden contributors.

Garnishments and Levies

The activity of responding to garnishments and levies includes all costs associated with payroll requirements placed on the employer due to claims against employees. Indications are that this is not one of the major burden contributors.

3.1.2 Employer Categories

To better understand how wage reporting burden affects the employer community, it is convenient to think of the business community as consisting of large and small employers. While size, as measured by the number of employees, is not by itself a significant determinant, it is strongly related to those that are. For this study, *large* implies multi-state operations, multiple employee classifications, complex benefit programs, and payroll processed by in-house integrated automation. *Small*, on the other hand, generally implies single state operation, single employee classification, simple or no benefits program, and mostly manual labor for record keeping, submission, and responding to government queries.

There are over 6 million businesses employing between 95 and 115 million employees depending on whether or not government agencies and other special employers are included. Figure 3-4a shows the number of employers by employment size groups and Figure 3-4b

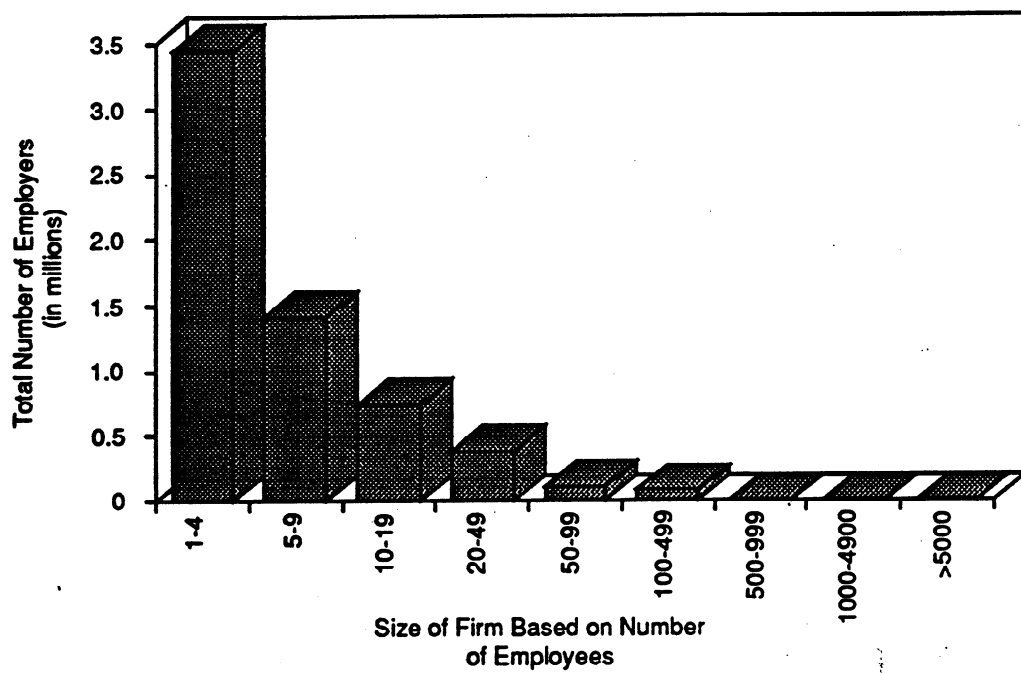


Figure 3-4a
Number of Employers by Size

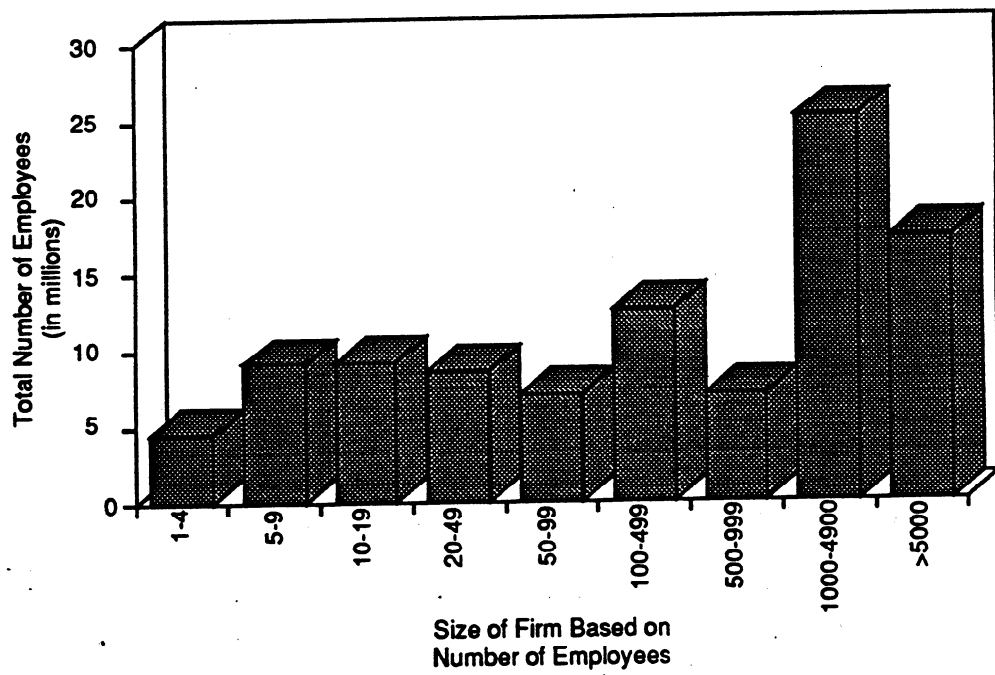


Figure 3-4b
Total Number of Employees by Size

shows the number of employees in those same size groups. Over half of the businesses have fewer than five employees, while, at the other extreme the 1,900 businesses with greater than 5,000 employees employ over 16 percent of the nation's workforce. Lacking sufficient statistical data, it is estimated that approximately 56,000 businesses employing 55 million workers fit the description for the large employer category used in this study.

The formation of new businesses (not by merger or sale) presents a special case. SBA estimates that 734,000 businesses were newly formed in 1991. As a rule, they are small businesses fitting the description given above. The SBA, in its 1992 edition of *The State of Small Business*, indicates that new business formation by minorities (including women and groups for whom English is a second language) is growing at a faster rate than new business formation overall. For those new businesses where English (or Spanish) literacy is limited, understanding and complying with government requirements is particularly difficult. Clarification of working terms, such as biweekly, semi-weekly, and eighth-monthly, is confusing enough to some well schooled in English, let alone those in the non-English speaking community.

Another area where small employers have difficulty is in the separation of payment by deposit from information reporting by filing. For many, their only prior experience with IRS involved the submission of Individual Income Tax Forms where the instructions include the possibility of sending money along with the return.

To better understand the issues affecting all small employers, interviews with members of the National Association of Enrolled Agent (NAEA) and contacts with accounting professionals were held. These discussions indicate that awareness and comprehension of the tax laws are particularly low among their clients. Indeed, many of the clients come to the NAEA as a result of failure to know or understand requirements.

A number of businesses employ payroll and UI service providers as part of their solution to dealing with the burdens associated with wage reporting. The service providers offer an economy of scale for the processes particularly falling in the burden categories of record keeping and submission. They also provide assistance in dealing with notices and in understanding requirements. However, while these services may reduce some of the employer's administrative burden, they do not in any way eliminate the employer's legal filing and payment responsibility. Since these service providers must deal with all of the issues faced by large employers, they are treated as such in this study. On the other hand, NAEA and accounting professionals are treated as though they were temporary staff for small employers. In particular, the hourly rate they tend to charge is a component in the calculation of employer burden made in this feasibility study.

3.1.3 A Key Source of Wage Reporting Burden

On a very fundamental level, the nature of the burden and its root cause can be summed up in one word: *complexity*. Whether a business is large or small, complexity of wage reporting requirements, laws, regulation, and procedures is the key burden factor, and is exacerbated as the number of states (and localities) in which a business has operations and the degree to which that business's payroll operations have been automated and integrated (or linked via data sharing) with other automated systems such as human resources and job/labor accounting increases.

3.1.3.1 Complexity

The concern about the increasing complexity of tax law and regulation in general, and the wage reporting aspect in particular, have been discussed in a number of forums as will be noted later in this section. However, it seems that unless one is actively involved in wage reporting, the degree of complexity is masked by the deceptive ease and regularity associated with the receipt of our own pay stubs.

In *Blueprint for Tax Simplification*, the American Institute of Certified Public Accountants (AICPA) Tax Division, presented at the IRS Research Conference, 14 factors are identified and discussed as affecting the complexity of tax law and regulation. These factors are:

- General factors
 - Complexity due to the effects of change
 - Complexity caused by subjectivity
 - Lack of consistent concepts
 - Structural complexity
 - Effect on taxpayers not targeted by a particular provision
- Specific factors
 - Communications complexity
 - Computational complexity
 - Complexity of forms
 - Administrative complexity
- External factors that affect the tax system
 - Legal complexity
 - Transactional complexity and business dynamics
 - Diffusion of responsibility

- Inconsistent application of rules
- The legislative process

At the Federal level, Circular E has six pages out of 64 total devoted to special rules for various types of services and products. This includes 91 line items entitled "Special classes of employment and special types of payments." Similar guides issued by some states have even more pages of rules.

In the two-volume *Payroll Tax EZ Handbook* and *Tax Calculator*, published by Vertex, Inc., in addition to base pay, there are 15 types of payments identified: awards and prizes, bonuses and commissions, cafeteria plans (Section 125), company cars (personal use), deceased employee's wages, dismissal payments, education assistance, 401K plans, group term life insurance (coverage in excess of \$50,000), jury duty pay (difference between regular wages and amount received for jury duty), moving expense reimbursement, pension/annuities, sick pay, travel expense reimbursement, and vacation pay. There are ten footnotes dealing with the Federal tax law for these items. Among the three Federal employment taxes -- income tax withholding, Social Security tax, and Unemployment tax -- there are different treatments of many of these 15 categories. Table 3-1 shows the sort of variation among the Federal and state agencies in treatment for just nine of these items.

Looking at how the states (including the District of Columbia, the Virgin Islands, and Puerto Rico) treat these 15 items, we find that there is little overall consistency (as shown in Figure 3-5). For income tax withholding, different sets of rules apply as to the inclusion, exclusion, any limitation of a particular component of wage:

- One group of 19 states applies a constant set of rules
- Three pairs of states applies three different sets
- The remaining 18 each have their own unique set

For UI, there is even less consistency:

- One group of seven states applies a common set of rules
- Another group of six applies a different set
- Two groups of three have two sets of their own
- Two pairs of states apply two different sets
- The remaining 30 each have their own unique set

Even where there appears to be consistent treatment of a type of payment required among states, it is not certain and the specific state regulations would have to be studied. Many of the Vertex charts and tables have footnotes such as "Withholding is not required at the time of payment; value may have to be reported on Form W-2." The ambiguity of the phrase "may have to be reported" exemplifies the uncertainty in the instructions with which taxpayers must cope.

Table 3-1
Examples of Different Treatment of Wage Components Across Agencies
and Levels of Government for Computing Income Tax Withholdings

Wage Component	Examples of Different Treatment of Wage Components by Various Federal and State Revenue and UI Agencies
Awards and prizes	All awards and prizes taxable. Exempt if award or prize for length of service. Exempt if award or prize for qualified program and amount less than \$500.
Cafeteria plans	Always taxable. Taxable if taken in cash.
Company cars (personal use)	Always taxable. Not taxable. Inclusion on W-2 at employee's preference.
Deceased employee's wage	Always taxable. Exempt if in the same calendar year as employee's death. Not taxable.
Educational assistance	Always taxable. Taxable if employer required education or training. Taxable if not employer required education or training.
Deferred compensation plans	Always exempt. Always taxable. Exempt if Federally qualified. Exempt if Federally and state qualified.
Moving expenses	Always exempt. Exempt if move over 20 miles. Exempt if move is intra-state. Always taxable.
Pension/annuities	Always taxable. Employee's preference, but must be reported on W-2. Always exempt.
Sick pay	Taxable if paid by employer. Exempt if paid by third party, but value must be reported on W-2.

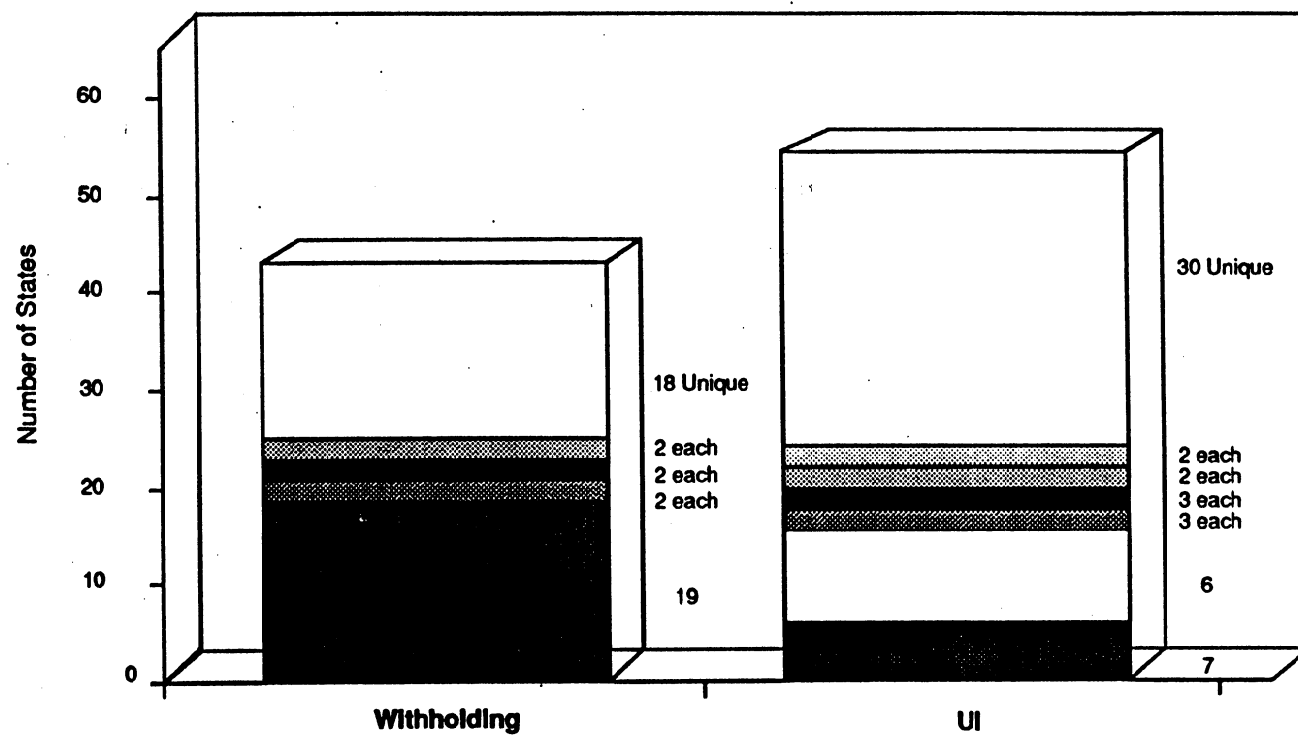


Figure 3-5
Count of States with Common Treatment of "Wage Components"

Another source of complexity comes from the differences in definitions. As an example, most, but not all, states derive their definition for employer and employee from that established by Federal law. The notion of what defines a resident, on the other hand, varies among the states. This, in turn, has some affect on the establishment of reciprocity. The use of electronic funds transfer and magnetic media reporting also varies.

The rules for reporting and depositing covering what is to be filed, who must file, how often, and when also show considerable variation. For example, one state requires its Annual Reconciliation report on or before 15 March following the calendar year being reported, while another on or before the last day of February following the end of each calendar year.

A number of states have combined payroll tax reporting and deposit with other state taxes such as sales and use. Some states have provisions for collecting local income tax in combination with the state income tax.

There was general agreement among the employer representatives (and the Federal and state stakeholders) that participated in this part of the feasibility study, that the legislative bodies are not particularly sensitive to the burdensome consequences of their actions. Reports reviewed indicate that the level of errors both by filers and tax processing agencies are a direct result of this complexity.

In summary, large employers are burdened by inter-jurisdictional complexity and by the rate of change imposed on their automated systems. Small employers are burdened primarily by complexity. Figures 3-6 and 3-7 provide a distribution of how large and small employers are affected by these factors.

Smaller employers benefit from having to deal with only the Federal and one state jurisdiction; the bulk of their burden is found in the area of record keeping. However, the lack of automation and the need to spread the cost of compliance over fewer employees per employer result in a higher cost per employee than that experienced by larger employees who, as a general rule, automate their payroll systems. For large employers, the need to deal with multiple states shifts a proportion of burden out of record keeping and into the other categories. For this group, the lower cost per employee of compliance highlights the efficiencies achieved through automation.

3.1.3.2 Change

The frequency of change in wage reporting laws and regulations contributes significantly to the burden of complexity. Table 3-2 shows the number of changes as reported by the Bureau of National Affairs for 1991 in their summary notice sheets to the Payroll Administrators (Handbook). The counts have been divided into three degrees of difficulty as defined in Table 3-3. This tally represents a rough indication of the frequency and complexity of changes that are imposed on employers. The frequency and scope of these

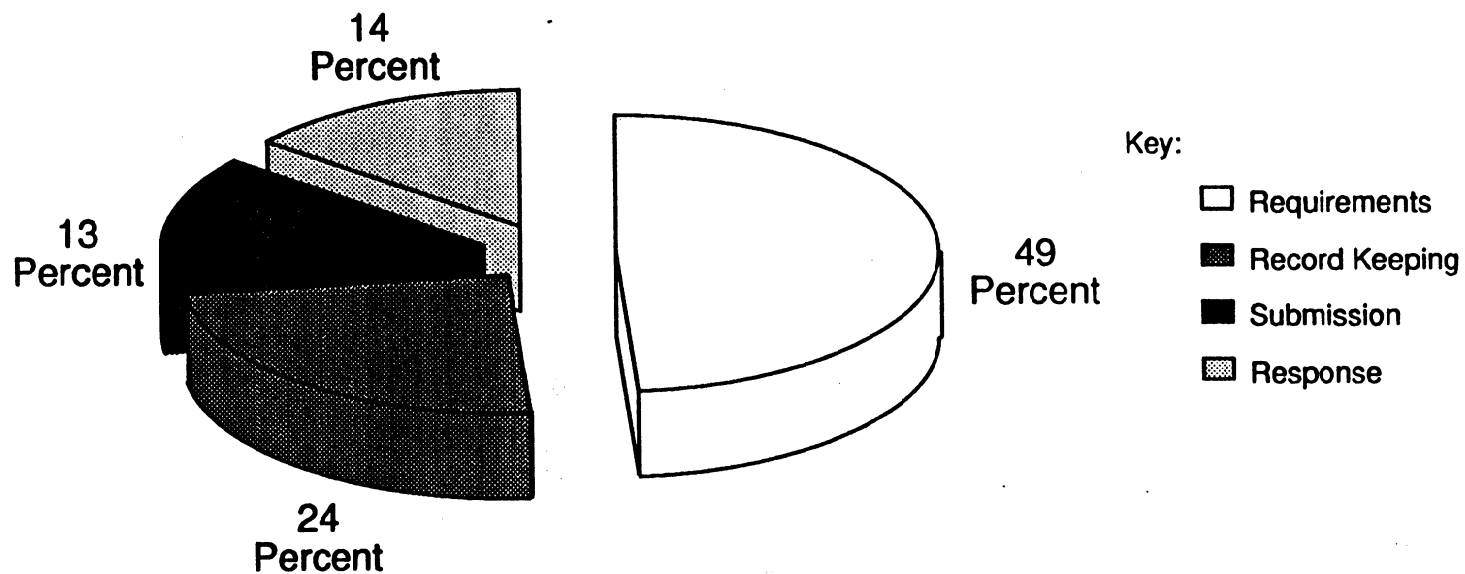


Figure 3-6
Distribution of Wage Reporting Burden of Large Employers

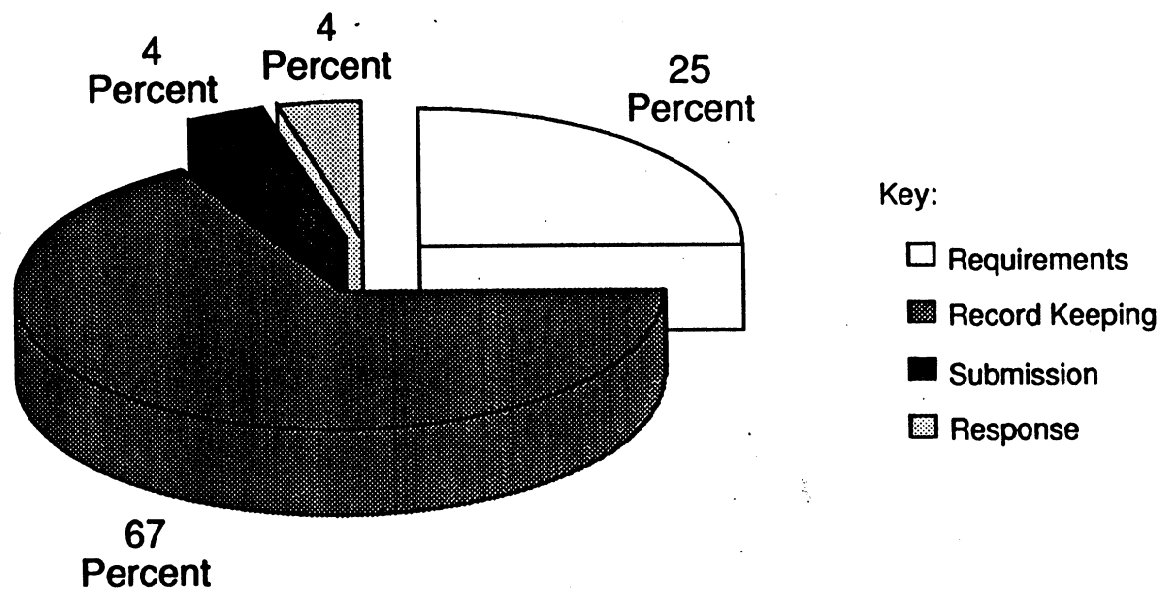


Figure 3-7
Distribution of Wage Reporting Burden of Small Employers

Table 3-2
1991 Frequency of Changes in Wage-Related Law or Regulation

Wage Category	Difficulty of Change			
	Low	Medium	High	Total
Federal Tax	14	21	74	109
Federal UI	0	0	1	1
State Tax	61	29	73	163
State UI	77	58	26	161
TOTAL	152	108	174	434

Table 3-3
Degrees of Difficulty in
Responding to Tax or UI Law and Regulation Changes

Degree of Difficulty	Definition	Example
Low	Changes that can be implemented by replacing existing control parameters within existing computer programs or in external data tables.	Changes in the rate or threshold for an existing tax, e.g., annual changes to withholding rates and FICA thresholds.
Medium	Changes that require the implementation of a new algorithm to replace existing computational procedures.	The calculation of a state UI tax liability requires a different series of calculations using existing data elements and producing revised results for existing data elements. New intermediate or temporary values may be required to complete the revised calculation. The existence of a new or revised worksheet is an indication of changes of this type.
High	Changes that require the addition of new data elements in the wage data base or on any existing form; or the introduction of a new form (but excluding the introduction of a simplified version of existing forms, e.g., 941EZ); or the revision of a reporting or depositing schedule; changes that require retroactive application even though they might otherwise be classified as Low or Medium.	The division of FICA into two parts (FICA and Medicare). The mandating of pay-stub changes to include new state tax data elements with concomitant changes to the forms submitted to the state.

changes, in turn, requires employers to modify their existing wage reporting procedures so that they remain compliant with Federal and state laws.

When existing tax laws are encoded into automated procedures, users of those procedures can achieve a degree of economy that automation offers. There are costs associated with the development and maintenance of automated systems. If the number and complexity of the changes are too great, then the benefits of automation can be reduced or even lost. It is in this area that representatives of large employers (directly and through their membership in professional societies) have been most vocal in their concerns about the current situation. Related to the burden resulting from the number and frequency of changes is the implementation schedule-related pressures and cost (including retroactive application) that arise when legislatures fail to consider the time needed to implement changes, especially the complex ones. Changes enacted at the last minute cause disruption of planned activities and operations which usually impose large, unanticipated costs on employers. This cost of required changes in automation is not, however, limited to the large employer with in-house software development staff. Smaller employers relying on vendor-supplied software packages are likely to have to purchase the latest upgrade or switch software entirely to keep pace with change. The latter may require extensive costs in re-entry of data into a new software package.

The specific cost of change is not separable from the total employer burden estimated in this feasibility study, but is thought to be a significant causal factor.

3.2 NEEDS OF FEDERAL AGENCIES

Wage reporting data plays a major role in meeting the missions and supporting the operations of IRS, SSA, and indirectly, through the UIS of DOL's Employment and Training Administration. In the brief descriptions of the operation and the general flow of wage-related data are provided for each of these Federal agencies.

In addition to the description of current operations, specific agency plans that will impact WRSP requirements and concept of operations are also briefly described.

3.2.1 Internal Revenue Service

The IRS administers the Federal tax program which generates all the income collected by the United States Government. Primary IRS activities related to WRSP include the receipt and processing of all tax payments provided by both individuals and businesses; the reconciliation and allocation of all revenues; the processing of all submitted tax returns; the securing of information about employers and employees required to operate the tax system; the conduct of all functions required to maintain the integrity, confidentiality, and availability

of tax data; and facilitating the necessary degree of compliance of all taxpayers within the system.

Essential to the operation of IRS, is the submission by employers of information on wages paid to employees and the amount of taxes withheld or paid out on behalf of those working employees. In addition, IRS must secure corresponding tax and withholding payments from employers on a periodic and timely basis. About 80 percent of all tax dollars collected by IRS are collected from payroll withholding and employer tax payments on behalf of employees.

IRS' wage reporting data flows and processes are closely linked to those of SSA and are depicted in Figure 3-8. The process starts when employers send information to IRS and SSA. IRS receives Form 940 FUTA returns, Form 941, Form 942 (Household), and Form 943 (Agricultural) tax withholding, as well as FICA, and Medicare returns from the employer. The Form 940 FUTA return represents the amount of Federal unemployment tax paid by the employer on behalf of all its employees. This return is currently filed annually. Forms 941 and 942 are currently filed each quarter. Form 943 is currently filed annually. IRS also processes any correspondence received from employers regarding an error in a filing, a missing return, or any other tax matter. Employers register their firm through the use of IRS Form SS-4. For any employee claiming more than 10 exemptions, the employers are also required to send a copy of that employee's Form W-4 for tax withholding computation. Although employers are instructed to submit tax and withholding payments via the FTD system, some, usually small and new employers, send payments along with their returns directly to IRS service centers.

Most employer tax deposits are made using FTD coupons and deposit to made a designated Treasury Tax and Loan (TT&L) depository bank. When these deposits are made, the TT&L sends an Advice of Credit (AOC) to the local Federal Reserve Bank which then deposits the aggregate payment through the Federal Reserve System into the Treasury account. The TT&L also sends a copy of the AOC and the FTD coupon to the IRS service center. An AOC listing is sent by the Federal Reserve System to the IRS where it is matched against the AOC listing and the FTD coupons received from the TT&L. IRS has 72 hours to allocate the monies received to the appropriate tax account and account for all money received.

IRS is responsible for processing all Forms 940, 941, 942, and 943 received from employers. If any type of error appears with regard to these returns, it is IRS' responsibility to contact the employer, research the case, or do whatever it takes to correct that error. IRS is also responsible for registering new employers and for collecting all the information necessary to establish a new employer in their data files and for updating any information provided by employers on a changed status.

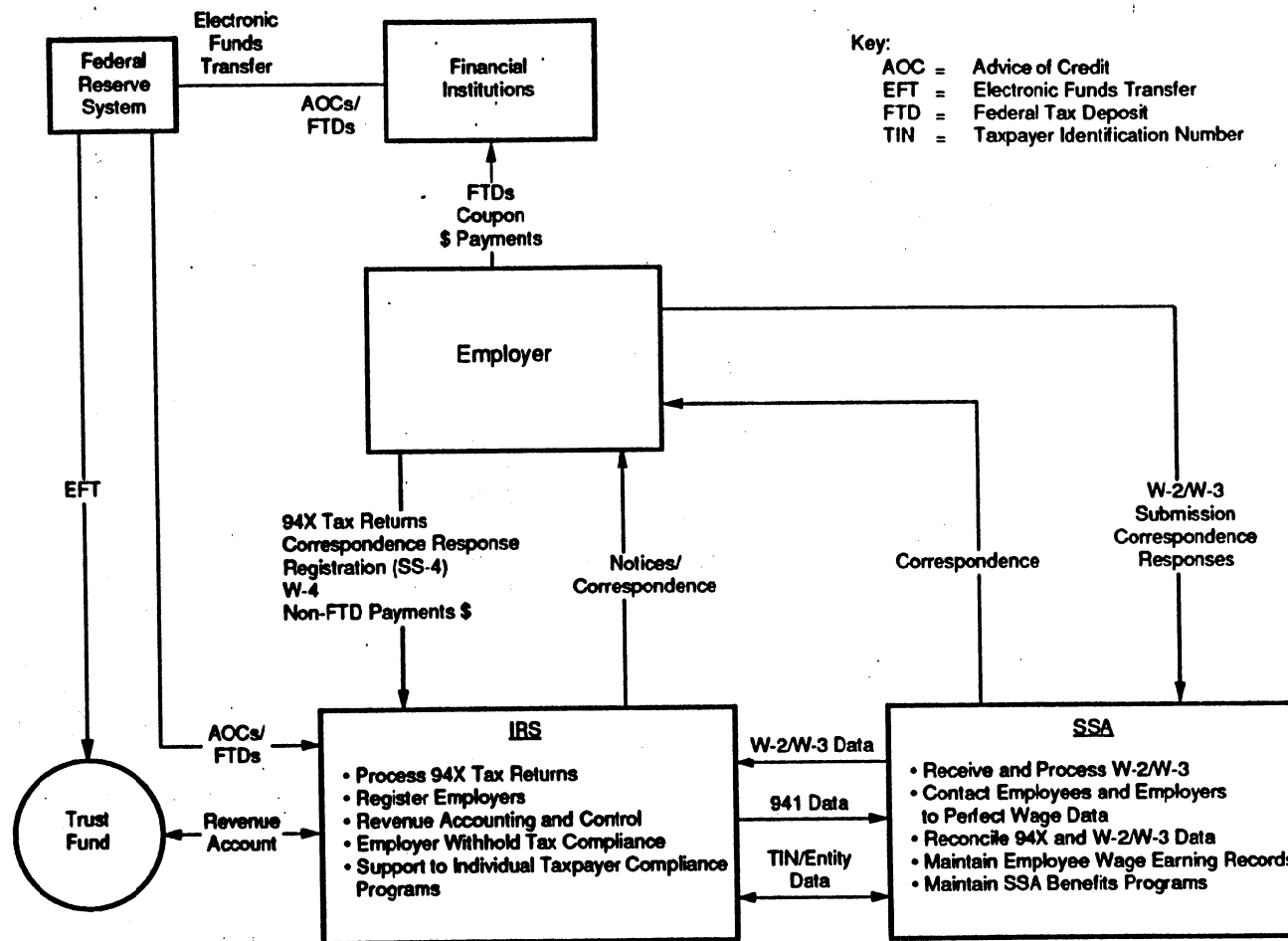


Figure 3-8
Wage Reporting Data Flows and Processes - Federal Agencies

IRS is responsible for all revenue accounting and must provide information to SSA on any tax withholdings and payments made by the employer to either Title II, Social Security, or Title XVI, Supplemental Security Income, benefits programs, or the Medicare program.

IRS provides information to SSA on the annual sum of all wages paid to employees. This information is used by SSA to reconcile its W-2 and W-3 wage reports and check for completeness of submission by employers. Reciprocally, IRS uses the SSA collected W-2 wage data in order to determine the completeness of employer compliance and to eventually identify potential individual income tax non-filers and underreporters. IRS and SSA share both employer and employee entity data and Taxpayer Identification Numbers (TINs) in order to ensure that they have the highest quality information possible.

IRS carries out the non-filer and underreporter compliance programs after it has received and processed both W-2 wage data and Form 1099 Information Returns payment data, and matched that data with data supplied by the taxpayer on his or her return and maintained in the IRS Master Files at the Martinsburg Computing Center (MCC). The non-filer and underreporter programs are executed through the use of correspondence out of the IRS Service Centers and can result in IRS field collection activities. IRS also carries out compliance activities related to employers who fail to withhold and deposit the correct amount of withholding and wage related taxes as indicated on their Form 94x returns.

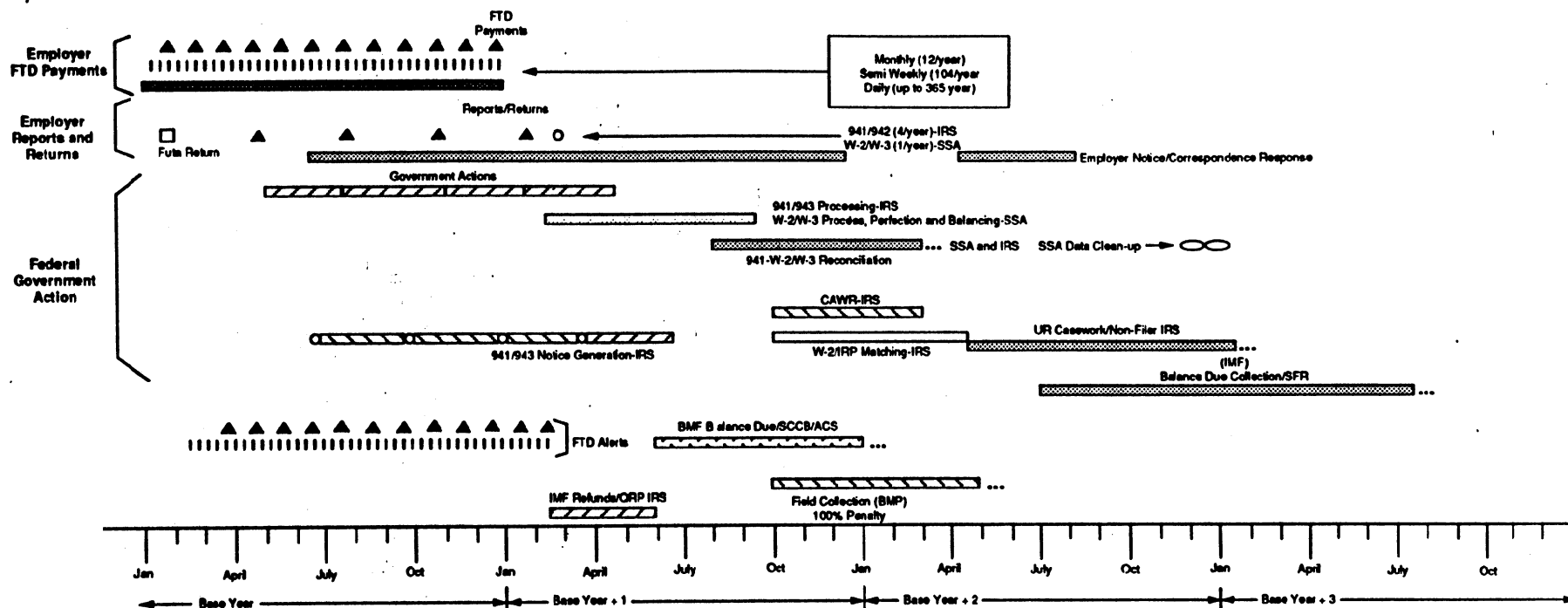
Today, IRS provides support to employers who must meet filing requirements and reporting procedures. IRS answers questions by telephone or in person through its Taxpayer Service function. It also publishes Circular E on employer filing responsibilities and conducts seminars for small businesses.

Figure 3-9 provides a timeline of the major Federal activities for IRS and SSA with respect to wage reporting and related downstream compliance activities. The top portion of the figure depicts the current operations, whereas the bottom portion of the diagram depicts future plans which may impact concepts for WRSP.

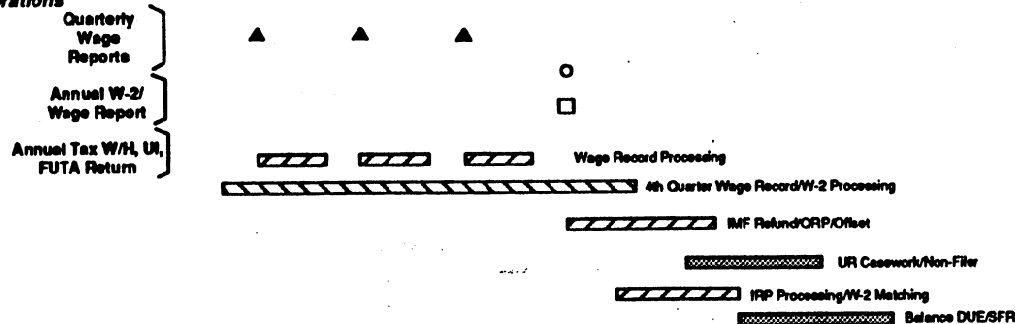
At the top left of Figure 3-9, the payments made by the employer and eventually received by IRS are shown. The payments typically range from monthly (the majority of smaller businesses) down to semi-weekly or even daily for the largest employers. These payments are indicated for the base year where the tax liabilities are actually incurred. Forms 940, 941, 942, and 943 return filing are also indicated. Forms 941 and 942 returns are submitted quarterly, and the 940 and 943 returns are submitted annually. Processing of the 94x series of returns starts immediately after receipt and is completed within about six weeks.

Once fourth quarter 941/942, and annual 943 returns are received by the end of January, IRS can begin to prepare for matching of SSA W-2/W-3 data to the 941/942/943 data. This IRS/SSA reconciliation cannot take place until all W-2s are processed by SSA. This requires that the reconciliation process begin in late summer following the base year.

Current Operations



Future Operations



**Figure 3-9
Federal Agency Wage Reporting Timeline**

IRS' Combined Annual Wage Report (CAWR) programs attempt to reconcile all the differences between the multiple sources of data. CAWR also adds income data from other sources and attempts to produce an aggregate income estimate. By the fall of the following year, the Information Returns document matching programs will start. This includes the individual W-2 records from SSA. Once these matches are complete, the underreporter and non-filer processes can begin.

The underreporter and non-filer compliance processes cannot start until at least one year after the base year's time of filing (February through April of base year +1). Balance due collection steps and substitute for returns generation can start after the underreporter assessments have been performed. Collection activities will continue well into base year +3.

Compliance actions focused on the employer and their tax payments occur much earlier than do individual income tax compliance actions. FTD alerts and notices to employers will occur within six weeks of an FTD due date. For employers that have a history of delinquency, collection response can be very rapid. Business Master File (BMF) balance due activity will start before the end of the base year for earlier payment periods after the 94xs are processed. This compliance activity will continue into the base year +1 time period. By later in the base year +1 period, the field collection activity will commence, such as the initiation of the Trust Fund Recovery collection process and the substitute for return process for non-filers. For historically delinquent employers, these actions can be considerably accelerated.

The Individual Master File (IMF) refunds and the questionable refund program are shown in Figure 3-8 at the bottom of the current operation description for IRS and SSA. These programs occur during the tax filing period at the beginning of the base year +1. During this time IRS has no wage reporting data that it can use to determine whether a return is fraudulent or whether the taxpayer actually has an additional liability that would reduce the size of his/her expected tax refund. Currently, these latter determinations are delayed for about a full year after taxpayer submission before they can begin.

As indicated below the time line axis in Figure 3-9, IRS is presently considering significant acceleration of its compliance action schedule. This future returns processing and compliance concept assumes that wage record processing can be accelerated to occur between February and April of base year +1. Previous year's W-2 will be processed by 15 March. This process will greatly accelerate IMF compliance and will save over a year and one-half of delay in performing those compliance functions. This earlier posting of wage records to individuals accounts will reduce the threat of questionable refunds. In general, IRS will become substantially more responsive and timely in meeting compliance assurance obligations.

3.2.2 Social Security Administration

The role of SSA within the Department of the Health and Human Services (DHHS) is to implement the provisions of the 1935 Social Security Act, Title II, which provides for retirement, disability, and survivors benefits for qualifying citizens. It also implements the Title XVI program for Supplemental Security Income for citizens who do not have adequate means of support. In addition to these two roles, SSA also supports the Medicare system by accounting for Medicare taxes. In fulfilling its mission, SSA must collect employee wage information from employers and must keep account of those wages paid to workers subject to Social Security and Medicare tax. The Form W-2 wage information used by IRS for income tax purposes is also used as an inherent part of administering SSA's entitlement programs.

SSA must store and maintain those wages for a period of time adequate to ensure that correct benefits entitlement can be determined for all potential beneficiaries. Determination of benefits often occurs many years (sometimes in excess of 50 years) after receipt of W-2 wage reports. Contacting employers to correct potential reporting errors after such delays is often not possible. As such, SSA requires a very high degree of accuracy in the data submitted by employers and posted to its Master Earnings File. SSA expends considerable resources to assure data accuracy, employing automated aids and manual research to correct inaccurate Social Security Numbers (SSNs), and contacting employees and/or employers when in-house research does not resolve un-postable conditions. Congress recently mandated that, beginning this decade, SSA must provide all potential beneficiaries with an annual Personal Earnings and Benefits Estimate Statement. This latter program adds additional timeliness and accuracy pressures on SSA's recorded data, and on the ability to make timely corrections when necessary.

Once SSA has determined entitlement eligibility, it initiates benefit payment by preparing requests for payment through the Financial Management Service of the Department of Treasury. SSA also monitors compliance with the regulations determining the amount of benefits rightfully owed to recipients and takes steps to recoup any overpayments made. As part of this latter activity, SSA uses UI data from the states to cross check eligibility for Supplemental Security Income benefits. Thus, SSA is also concerned about the timeliness and accuracy of these data.

Much of the current wage reporting activities performed by SSA have been circumscribed by the previous description of the IRS operations. At present, SSA starts to receive W-2/W-3 reports from employers in paper and magnetic form after the beginning of base year +1. By the end of February, all W-2/W-3 reports are required to be submitted. Currently, SSA processes in excess of 70 percent of reported earnings within 6 months of the end of the tax year. The processing continues until to about September of base year + 1. SSA plans to further accelerate this annual processing cycle. The processing of W-2s continues for late filers or for those who make W-2 corrections. SSA will follow up on any wage information that it cannot correctly post because of bad SSN or SSN/name mismatch.

SSA will start its reconciliation process at the end of the base year +1 when SSA receives information from IRS on the sum of the 941/942/943 return wages paid for the base year in total. These are compared to the W-3s for each employer to determine whether there is a wage discrepancy which could bear on the accuracy and completeness of the W-2 information. Reconciliation can proceed well into base year +2. After this point, SSA will continue to perfect the wage data records in order to ensure that they are of the highest accuracy and completeness. Currently they are estimated to be 99.2 percent correct, and goals have been established to improve on this level of accuracy even further.

SSA benefit programs administration, which relies heavily on the use of the employee wage records, is not depicted on the timeline because it is an on-going process which is asynchronous to wage reporting. Currently, SSA has several programs focused on assuring the accuracy of its benefits programs. These include data exchange with states to verify births, deaths and marriages, and use of UI data to assure eligibility for SSAs Title XVI Supplemental Security Income program.

3.2.3 Department of Labor

The UIS of DOL's Employment and Training Administration provides Federal level oversight of the UI program that was also established by the Social Security Act. The UI program is operated mainly by the 50 states the District of Columbia, Puerto Rico, and the U.S. Virgin Islands all of which have UI coverage for workers. The UIS monitors the activities and performance of the State Employment Security Agencies (SESAs), and it assures that state laws conform with Federal law requirements. It also monitors the collection of state and Federal UI taxes paid by employers and the status of state trust fund accounts. The UIS is responsible for compensating the states for their UI efforts and thus must maintain an understanding of each state's UI operation. In addition to the UIS, DOL is also responsible for the operation of the BLS. The BLS collects, analyzes, and publishes data collected from employers through the state UI programs in order to provide information on the state of employment in the United States. (The interactions of UIS and BLS with wage data reporting are discussed in Section 3.3.2).

UIS obtains information (weekly, monthly, quarterly, and annually) from each of the SESAs on workload, performance, and quality measures. UIS uses the reported information to determine the amount of funds that will be transferred to the states to fund the costs of their operation of the UI program. UIS also monitors the status of the UI trust funds and responds to the state's requests for additional funds when the state trust funds are emptied during periods of prolonged economic downturn.

The BLS contracts with the SESAs to provide data for the ES-202 report on total UI covered employment, wages, and contributions according to the area, ownership, and industrial classifications of the reporting employers.

3.3 NEEDS OF STATE AGENCIES

Like the Federal agencies, the state agencies responsible for collecting state employment taxes require accurate and timely wage reporting. A brief description is given in the following sections on the collection and use of employment tax and wage information by the states.

3.3.1 State Tax Authorities

Forty-two of the fifty states collect personal income taxes from their residents. The largest share of these taxes is paid by employers on a periodic basis through withholding from employee wages. In some states, the state tax authority also collects other wage and/or non-wage related taxes using a common (single) return and payment. The states receive tax payments through a variety of mechanisms. Some accept only payments mailed to the tax agency, while others accept electronic funds transfers or payments to depository banks. As these payments are received from employers, entries are made to the employer account to show amounts paid by type over time. At the end of each tax year, audits are conducted on some of these accounts to ensure that amounts submitted (payments) match amounts withheld (liabilities).

In many cases, states sign agreements with IRS to receive Federal tax return information. Some states have similar agreements with other states to exchange tax information. The Federal and other state information is matched with state account data to detect under payments of withholding taxes by employers. The state tax authorities also often request the SESA to furnish wage data on individuals to check for proper payment of individual income tax.

Figure 3-10 shows the flows of employment tax returns, payments, and information among the employers, states, state agencies, and Federal agencies. The process commences with a new employer registering with the state tax authority. In some states this process has been consolidated to allow the employer to register at the same time with the tax authority, the SESA, and other state agencies. In other states, multiple registrations are necessary, one to each agency with which the employer deals.

Following the registration process, which includes the assignment of a state tax identification number (often the same number as the Federal Employer Identification Number (EIN)), an account is established in the employer's name and a book of payment coupons is sent to that employer. When the state tax identification number is different than the Federal EIN, the latter is often requested and used as a cross-reference. As wages are earned, the employer makes withholding tax payments to the state. The timing of these payments varies from state to state and from employer to employer, although the deposit rules of IRS are now

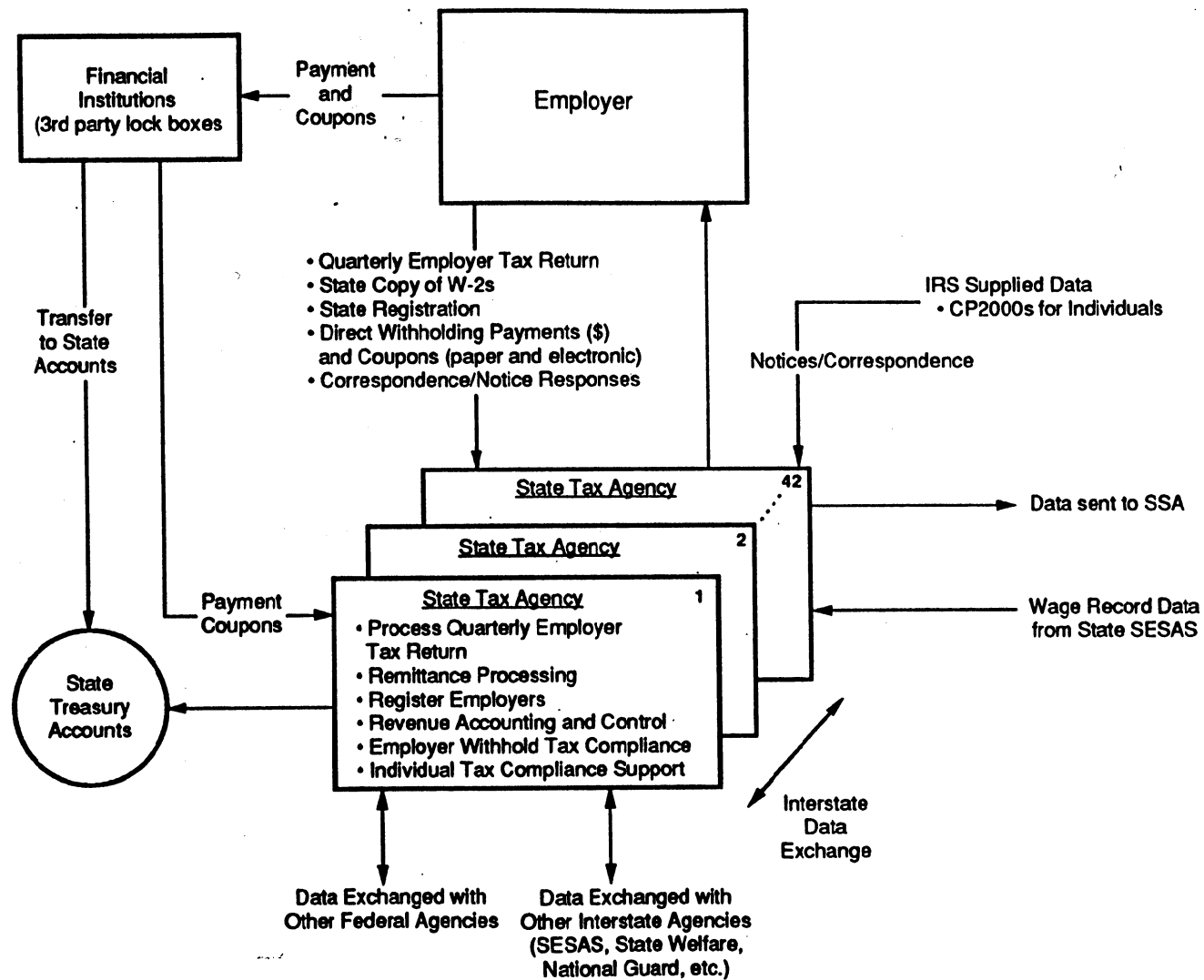


Figure 3-10
Wage Reporting Data Flows and Processes - State Tax Agencies

used in many states. Employers submit a return, usually on a quarterly basis, to report their liability for employment taxes and to summarize their payments.

If the state detects an under or over payment or determines that payments are delinquent or were made late, a notice and possibly an assessment of interest and penalties is sent to the employer. The employer responds to these notices in writing in most cases, but telephone responses are also common.

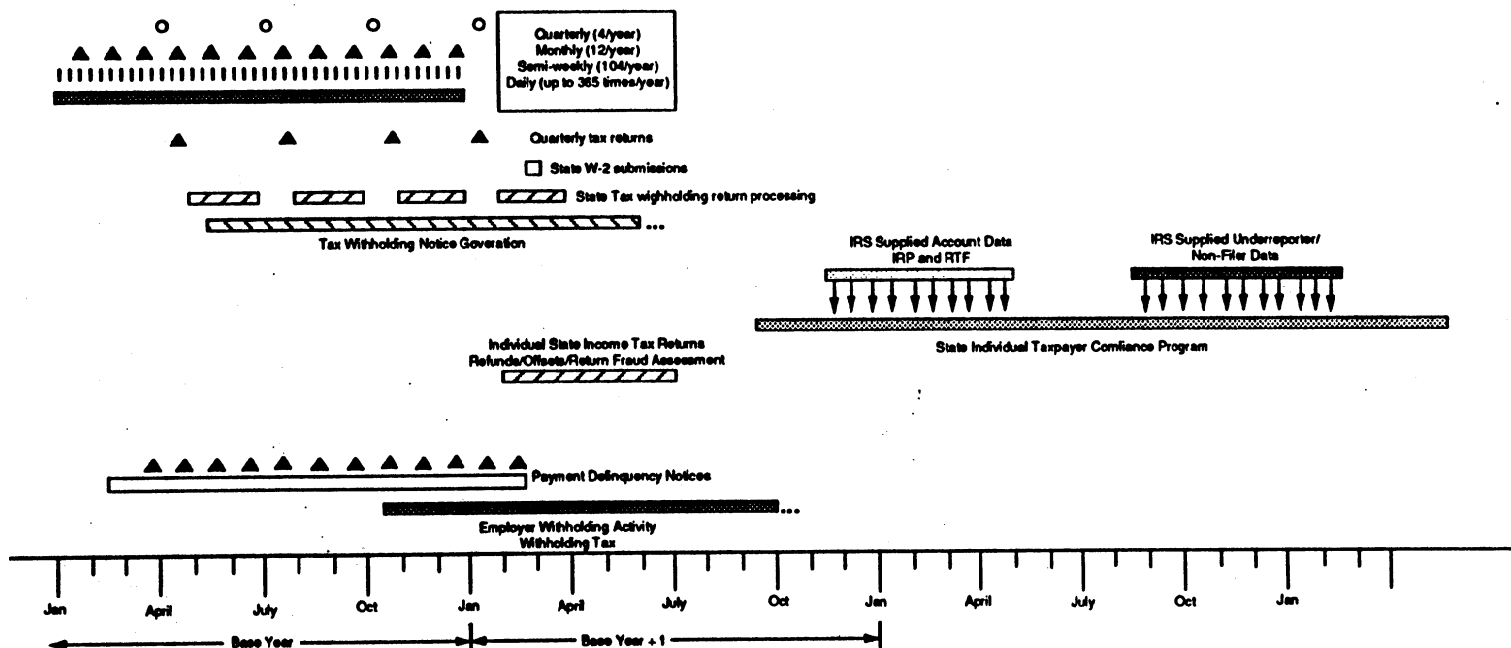
Some states use lockbox contractors to receive and process employment tax payments, while others do all of the work in house. In either case, the state must correctly credit employer accounts with funds received. Unpostable items must be resolved, often through considerable effort and contact with the submitter. Payment coupons and checks are compared and reconciled if they are in disagreement. Exceptions must be handled. They include checks without coupons, several checks for the same account, and one check for several employers.

Tax return information must also be entered into the employer account and tax agency data bases. The states expend considerable effort in capturing and perfecting the return data. Even when modern optical scanning and optical character recognition (OCR) methods are used, a large amount of manual data keying is required. Few states today are able to take advantage of electronic data interchange or electronic filing of employment tax return information. Some states have contracted out the entire data capture and perfection operation, but the effort is none the less significant.

Within one or two months after the end of each tax year, the states receive state copies of Form W-2 for each employee from their employers. Large employers usually provide this information on magnetic tape or diskette. States use W-2 data to varying degrees for a variety of compliance-related programs, most of which focus on reconciling employer payments and annual wage reconciliation reports against the sum of withholdings reported on W-2s. Most states also obtain the results of IRS' underreporter program and use same to recover related underpayment of state income taxes. In addition to data sharing with IRS, some states have data sharing agreements with neighboring states and with the state UI agency. These data are used to enhance state tax compliance programs. Some states also participate in coordinated multi-state audit programs for larger business operating in multiple states.

The timeline in Figure 3-11 shows the major state tax agency activities. Enhancements to state compliance activities are possible. More rapid and complete processing of W-2s would allow the tax authority to identify questionable refunds, locate non-filers, and identify the place of employment of taxpayers owing money to the state. The tax agencies could also use the place of employment information to locate delinquent non-custodial parents who owe child support.

Current Operations



**Figure 3-11
State Income Tax Agency Wage Reporting Timeline**

If data from multiple states were available, states would be able to compare wage data to identify taxpayers who fraudulently claim refunds in more than one state. Acceleration of Federal compliance programs upon which the states currently rely would also improve state compliance activities.

3.3.2 State Employment Security Agencies

The state employment security agencies administer the Federal/state cooperative unemployment insurance programs. All of the states as well as the District of Columbia, Puerto Rico, and the Virgin Islands have a SESA. They collect UI taxes and wage reports from employers with workers in their state and process claims for UI benefits.

Figure 3-12 depicts the data flows and processes of the SESAs. The process begins when a new employer in the state submits a registration form to the SESA. As noted earlier, some states combine this registration with that of other state agencies. After receipt and processing, the employer is issued an identification number for reporting to the SESA. This number is different from the employer's Federal EIN and/or state revenue identification number. Preprinted tax return forms (i.e., contribution reports), together with filing and payment instructions, are sent to the employer. The filing format varies considerably from state to state and is usually quite different than that used for filing employment tax returns to the state tax agency.

Employers submit a UI tax return on a quarterly basis to the state. As a part of these quarterly submissions, the employer provides a record of the wages paid for the quarter to each employee. Depending upon the specific state procedures, the UI tax returns and wage records may be sent to the same or different physical location. Accompanying the return is a payment of the UI tax. In some states other taxes such as a disability insurance tax are also paid with the UI tax payment. These items are processed by the state in much the same way that employment tax returns and payments are processed by the state tax authority. In some states, the operations are combined using a single quarterly return. In most states, however, separate operations are conducted.

Because the SESAs receive Federal funds to conduct the UI program in their state, they make frequent reports to DOL. These reports summarize SESA activities and enumerate claims filed, benefits paid, appeals, and other information. Similar data are sent to DOL BLS and to state labor, economic development, and planning agencies.

The SESAs often receive wage reports from employers with missing or inaccurate employee SSNs. Due to the low usage of wage records to determine the monetary eligibility of those applying for unemployment benefits and given the short useful life of these records, the SESAs spend little effort to resolve these anomalies. Suspect SSNs and names are sent to SSA for validation. The process is time-consuming and often only confirms the suspicion that an invalid or duplicate SSN has been reported.

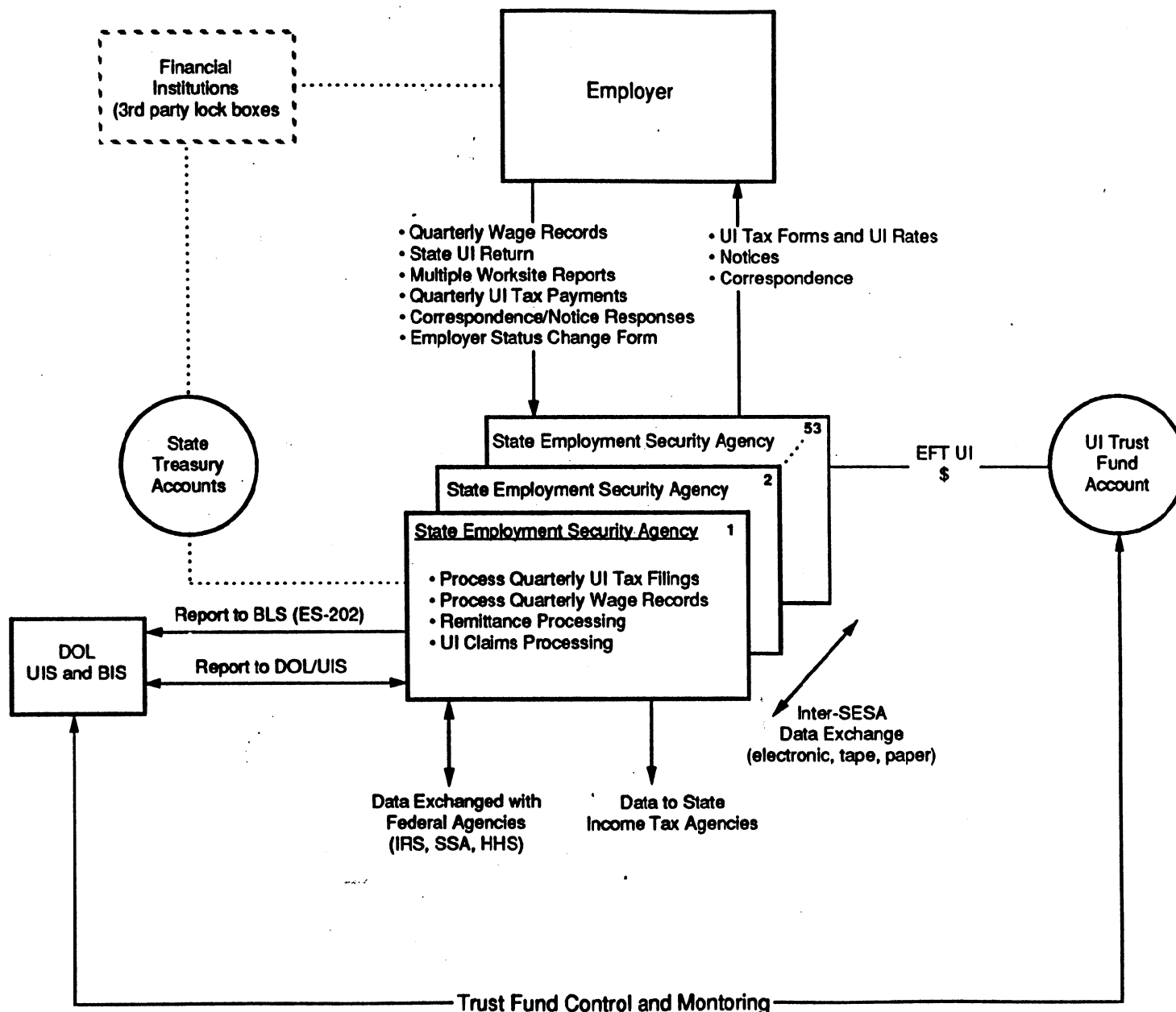


Figure 3-12
Wage Reporting Data Flows and Processes - State Employment Security Agencies

Audit activities and processing uncover discrepant payments and inaccurate wage reports. These situations lead to notices to the employer to correct the error or to pay the proper tax together with any interest or penalties that have been assessed. Employer payment history is also used for verification of FUTA tax credits taken by employers in filing Form 940.

The most prevalent use of the wage data reported to the SESA is for determining the eligibility from a monetary (wages earned) viewpoint of claimants for UI benefits. The claims offices normally retrieve the past wage data for a claimant while he or she waits and make an initial determination. A difficulty arises when the claimant's wages were earned in more than one state, earned in a state other than where the claim is made, or earned from the Federal government or while in the armed services. In these cases, wage data must be obtained from another state or a Federal agency. This process can take up to two weeks or longer.

A secondary use of UI wage data is in compliance matching using lists received from other agencies. For example, SSA requests certain states to match lists of recipients of Social Security disability or Supplemental Security Income benefits against wage reports in order to identify whether the recipients are no longer entitled to the benefit payments. In addition, matching and data sharing, to the extent allowable by law, are also done in order to identify potential income tax non-filers at the Federal and state level, to support the child support enforcement program, and to test for eligibility for food stamp and other welfare programs, as well as similar eligibility determination and compliance activities.

A timeline of the activities of the state employment security agencies is given in Figure 3-13. The figure shows the timing of current UI tax and wage reporting activities. Improvements in the time to locate out-of-state wage records in support of UI claims processing may be possible through a more coordinated and automated national wage record concept, as well as child support enforcement and related programs. Improvements in the quality of wage records would reduce the need to contact the employer to verify wages when current wage records are inadequate.

Current Operations

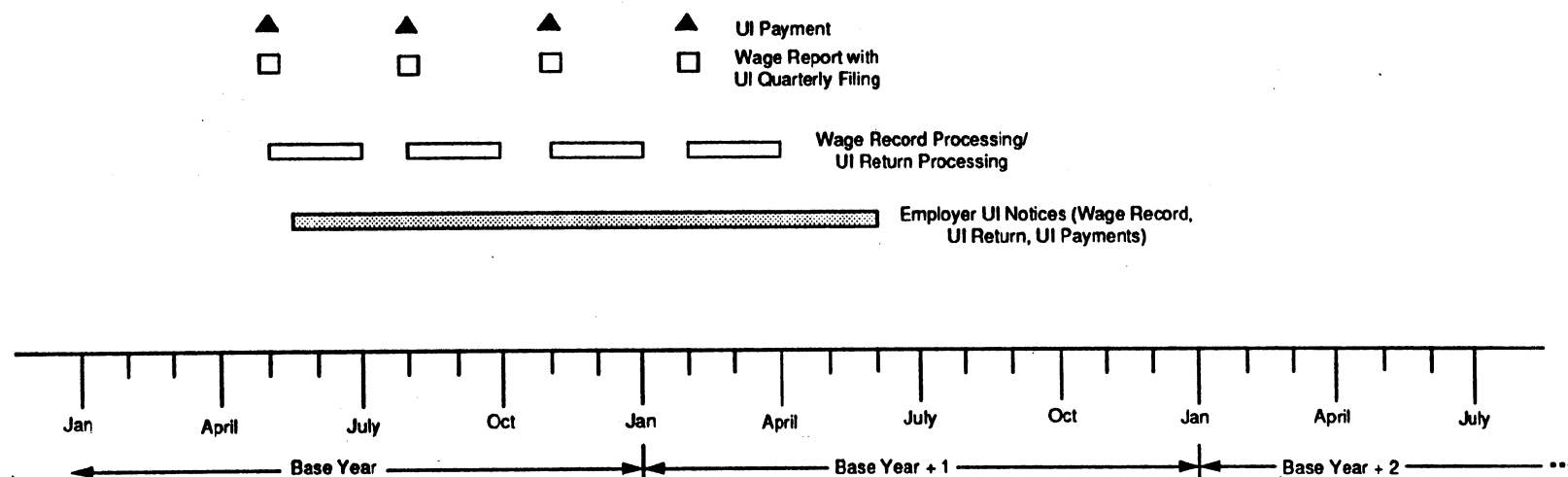


Figure 3-13
State Employment Security Agency Wage Reporting Timeline

SECTION 4

ALTERNATIVE WAGE REPORTING SIMPLIFICATION PROJECT CONCEPTS

To assess the feasibility of providing a simplified wage reporting process, alternative WRSP concepts were developed, and the costs, benefits, and impacts that would result from the implementation of each concept were analyzed. Each of these concepts has a different scope and functionality. In this section, the range of potential WRSP scope and functionality is discussed. This is followed by the definition of the three concepts analyzed and a description of the technical architectures developed to address the requirements.

The three alternative WRSP concepts described herein represent a broad range of possible WRSP scope, functionality, and systems. Because they were developed at a high-level and only for the purpose of assessing the feasibility of WRSP, these three concepts do not represent specific designs for program implementation. Should a wage reporting simplification program be implemented, it is most likely that it will fall somewhere within the range of the concepts presented. However, the final scope and functionality of a WRSP system, as well as recommendations for its implementation that arise from the later phases of the feasibility study, will be determined by 1) the assessed impacts of WRSP on the major WRSP stakeholders, 2) the willingness of Federal and state agencies to participate in the program, and 3) the feasible migration paths from the current wage reporting systems to a WRSP system. As previously noted, this report on preliminary feasibility study findings provides a basis to begin this process of assessment and decision making.

In all WRSP concepts, information regarding employment, employee wages, and employer and employee taxes will, to varying degrees, be processed, stored, and made available to authorized users for administering their governmental programs. As such, safeguarding individual privacy, assuring confidentiality, and avoiding unauthorized disclosure of these data will be very significant factors in the ultimate implementation of any WRSP concept. Given the scope of the current feasibility study, such privacy, confidentiality, and security considerations are taken as requirements. Specific details regarding policy and design of systems needed to assure privacy, confidentiality, and disclosure are to be addressed in future program activities.

4.1 POTENTIAL RANGE OF WRSP SCOPE AND FUNCTIONALITY

The alternative concepts formulated in this feasibility study are defined in terms of the scope of the overall project and the level of functionality for the specific system and services provided. Project scope deals with the degree to which a given concept addresses change or harmonization in laws, regulations, and administrative procedures that affect key aspects of employer burden. The scope of a concept also encompasses the types of information and

payments being processed. Functionality pertains to the specific services and processing activities included in an alternative WRSP concept.

4.1.1 Potential Scope of WRSP

Table 4-1 identifies three areas of WRSP scope: laws, definitions, and procedures; information processed; and payments processed. The analysis of employer burden carried out as part of this feasibility study indicated that much of this burden may be reduced through simplification and harmonization of laws, regulations, and procedures under which agencies and employers currently operate. The degree to which WRSP addresses this complexity reduction is a key variable in defining the WRSP concepts. To some extent, establishment of what may be termed a more harmonized wage code, which would be used to administer wage-related taxes and reporting across agencies participating in WRSP, may be viewed as similar in concept to formulation and adoption of the Uniform Commercial Code which, having been adopted by 49 states, simplifies the process of conducting business across the country.

The scope of wage code harmonization would, however, be substantially narrower than the Uniform Commercial Code. It would address such things as administrative commonality in filing procedures, standardization of reporting formats for various filing media, unification of an employer identification numbering system, and coordination of filing periods and due dates. It would also address such issues as who is an employer and employee, who is an independent contractor, what are the definitions of wage components, and which of these components constitute reportable wage. To assure flexibility for the participating governments and agencies in raising required revenues, it would not attempt to harmonize items such as the wage base or tax rate used to determine taxable wage and amount of tax. The degree to which such wage code harmonization is assumed to be in place is a significant factor in the WRSP concepts described later in this section.

The remaining two areas, information processed and payments processed, determine the types of agencies that WRSP can support. Depending on the data contained on integrated WRSP returns, WRSP will be able to support a specific combination of Federal agency (primarily IRS and SSA) and state (revenue commission and employment security) agency needs. In addition, the scope of WRSP will determine whether payment processing is supported for Federal, state, and UI taxes. Such payment processing support would provide services similar to lockbox operations and electronic payment processing currently used by both Federal and state agencies. Because several states currently have single coupon payment systems that are used to process some combination of revenue tax, unemployment contributions, sales and use tax, excise tax, and estimated income tax, an agency option is included in the payment process scope for handling combined payments through WRSP.

Table 4-1
Range of Scope of the Alternative WRSP Concepts

Laws, Definitions, and Procedures	Information Processed	Payments Processed
<ul style="list-style-type: none"> • Filing periods and due dates • Filing procedures • Forms, formats, and media • Employer identification numbers • Data definitions • Wage component definitions • Reportable wage definitions • Worker classifications (employee versus independent contractor) 	<ul style="list-style-type: none"> • Federal employer wage tax • Federal employee wage and tax records • State employer wage tax • State employee wage and tax records • UI contributions • UI employee wage records 	<ul style="list-style-type: none"> • Federal tax and withholdings • State tax and withholdings • UI tax • Other state taxes

4.1.2 Potential Functionality of the Simplified Tax and Wage Reporting System (STAWRS)

Basic to all of the concepts analyzed in this feasibility study is that the Simplified Tax and Wage Reporting System (STAWRS) -- as distinct from the more encompassing WRSP -- will be seen as a single entity providing employment tax and wage reporting services from the viewpoint of employers and agencies. Though implementation of a simplified wage reporting system may be physically distributed among more than one site, employers will file returns, make payments, obtain assistance, and carry out any other interactions with either one STAWRS site or with one STAWRS service group. Similarly, participating agencies will deal with one STAWRS entity in obtaining data and revenues submitted to STAWRS and in using other STAWRS services. Figure 4-1 illustrates this general concept. Table 4-2 identifies five areas of STAWRS functionality that would be carried out within this singularity concept. Any aspect of functionality not provided through STAWRS would be provided by the agencies and governments currently fulfilling these roles.

Employer Services

The potential range of employer services to be provided by STAWRS includes the following.

- Combined employer registration: A service that would allow an employer to register with STAWRS for all Federal and state programs participating in WRSP. Upon registration, STAWRS would notify all participating agencies of the new employer or change in employer status, and would cause new employer information packages to be sent to the registrant.
- SSN validation: A capability for employers to check the validity of an SSN provided by an employee. By using this service, an employer may determine prior to submission of employee-level wage returns that it has a good SSN, thus reducing the likelihood of an unpostable wage or tax record and the need to respond to government notices of related errors.
- Registering fact-of-employment: A service by which an employer could indicate the hiring of an employee, most likely at the time of SSN validation. This service allows STAWRS to customize employee-level wage and tax returns with SSN and name control of on-board employees; a feature favored by small employers. This feature would reduce the need for employers to fill out these return data fields and thus reduce the likelihood of data capture errors on the part of STAWRS. It would also reduce the likelihood of bad error notices being sent to employers. In addition, this service would satisfy the needs of some states that have current requirements for such fact-of-employment reporting.

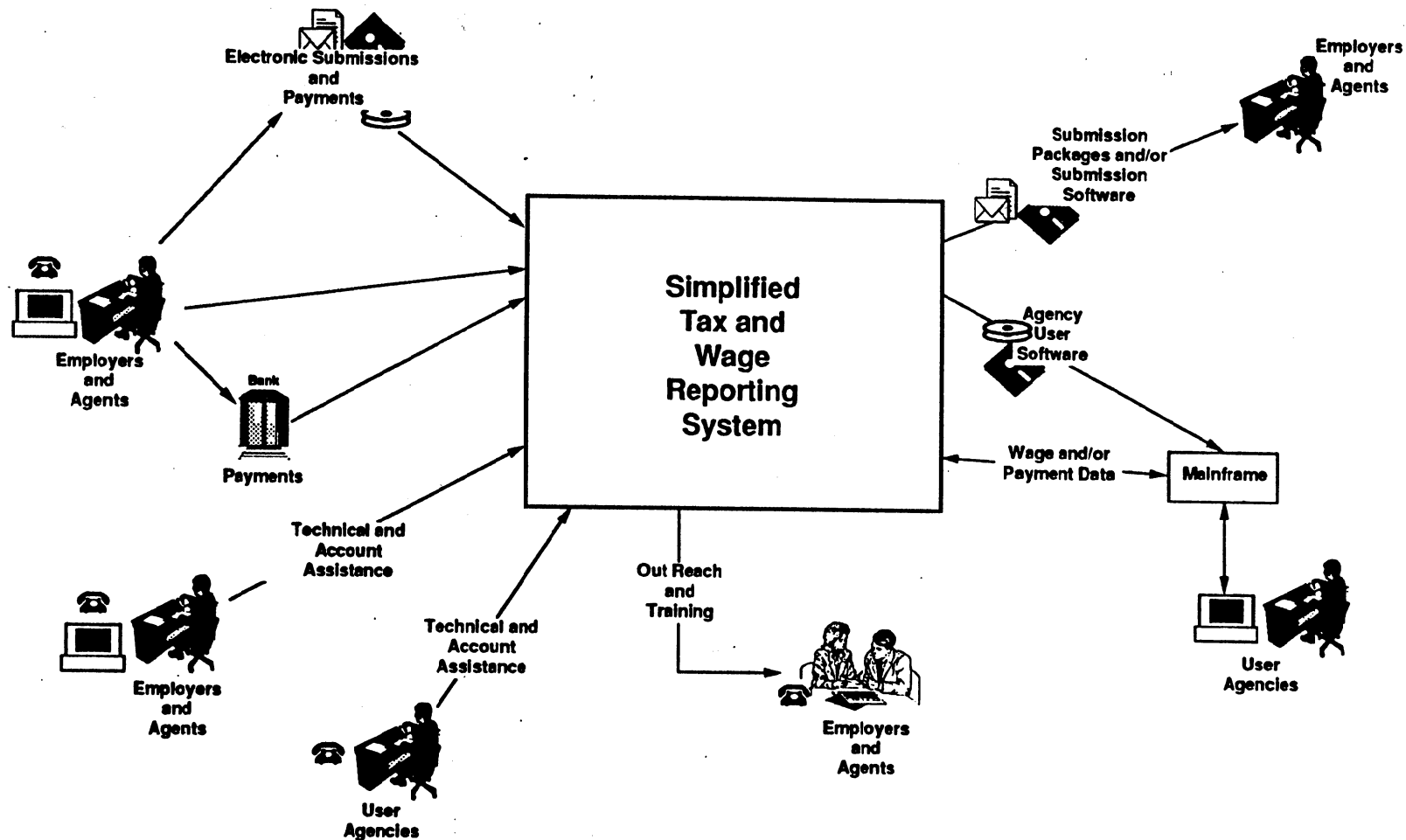


Figure 4-1
STAWRS – A Single Point for Employer Services,
Submission Filing and User Agency Data

Table 4-2
Range of STAWRS Functionality

Employer Services	Submission Processing	Returns and Payments Processing	Data Retention and Distribution	Compliance and Claims Processing Support
<ul style="list-style-type: none"> • Employer registration • SSN validation • Fact-of-employment • Employer training • Employer assistance technical • Employer assistance accounts 	<ul style="list-style-type: none"> • Forms simplification • Multi-media submission • Package customization • Package preparation • Package distribution 	<ul style="list-style-type: none"> • Mail processing • Remittance Processing • Data capture • Data editing/perfection • Data storage • Submission archiving • Unpostable resolution • Adjustment/amendment processing 	<ul style="list-style-type: none"> • Employer entity • Employee entity • Employer tax liabilities • Employer tax payments • Employer UI liabilities • Employer UI payments • Employee wages, tax, and with-holdings • Employee UI wages 	<ul style="list-style-type: none"> • Employer tax compliance • Employer UI compliance • Employee tax compliance • SSA claims • UI claims

- **Employer training:** An integrated training function that provides training in all areas of WRSP scope, employer services, and filing procedures. This service would take advantage of the latest training methods and modes (e.g., video tapes, educational TV, personal computer (PC)-based training programs, and specialized training manuals), and would, to the extent feasible, address specific needs of targeted audiences (e.g., foreign languages, problem business sectors, specific demographic regions).
- **Employer assistance technical:** A service that provides immediate response to employer technical tax and reporting questions. The service is envisioned to provide a one-stop capability for employer's questions. Both pre-recorded answers to common questions would be provided, as well as human assistance. Issues that could not be resolved by the primary tax assistor would be forwarded immediately to either a STAWRS specialist or an assistor at a participating agency. The service may also include an online bulletin board capability, as well as electronic mail for submission of queries and transmission of responses. Only in rare instances would an employer be asked to call another number or to submit the request in writing.
- **Employer assistance accounts related:** A service by which an employer may check the status of its payments processed through STAWRS. To the extent that STAWRS processes payments, this service will allow an employer to check how those payments were allocated among participating agencies, and to correct misallocations. To the extent that STAWRS keeps track of both payments and liabilities, the employer could also check current account balances.

Submission Processing

STAWRS submission processing functions address those features and activities related to the content of submission packages to be filed by employers; and the preparation, customization, and distribution of these packages.

- **Forms simplification:** The extent of forms simplification will depend on the scope of WRSP. Combined submissions would generally contain more information than contained on each of the numerous independent filings submitted today. However, redundant data fields would be eliminated and forms would be redesigned to simplify their completion. For paper filers, more than one version of a form will be available. For the small, one-state employer, an EZ-type form would be provided containing space for common data fields, as well as Federal data fields and one set of state-specific data fields. For mid-size employers, additional columns of data fields would be provided to allow reporting for several states. To the extent that wage code harmonization allows for increases in commonality, the numbers of data fields may be somewhat reduced. Using variable length records, STAWRS standards for magnetic and electronic filing would provide all the

flexibility needed for any size employer operating in any number of jurisdictions. Concomitant with simplification of data content, STAWRS would attempt to simplify forms layout and filing instructions in order to reduce the potential for misinterpretation and errors.

- **Media for distribution and submission of forms:** Employers and/or their agents would file their employment tax information, UI contribution information, and employee wage and tax information with STAWRS using either paper, magnetic, or electronic media. In addition to these traditional filing approaches, it is envisioned that STAWRS will also provide for filing using new approaches now being used increasingly by government and industry. Two such approaches targeted at the small and mid-sized employer include: (1) telephone filing using a touchtone phone and a STAWRS voice response unit similar to the system that was piloted in 1992 by IRS in its Form 1040 TeleFile test, and (2) employer's PCs attached via modem to a STAWRS computer and used to enter data directly onto STAWRS-generated input screens. Both of these approaches would provide an employer with immediate confirmation of receipt and acceptability (validation) of the data submitted. It is envisioned that an employer would indicate its preferred method of filing, and that STAWRS would provide a submission package that meets the employers needs. This may include, among other options, PC-based software for online filing, or interface software that may be integrated into business software vendor packages to support electronic or magnetic filing.
- **Media for submission of payment:** STAWRS will provide for payments in a variety of forms, including paper checks, electronic funds transfer, and credit card. Paper checks would be accompanied by a coupon similar to those being used today by many agencies, and which provide space for allocation of the single remittance to multiple agencies. Such coupons will be preprinted with the employers entity information. Electronic payments will be accompanied by an appropriate credit advice providing similar payment allocation information. As a means does not currently exist for similar information to accompany credit card payments, for the present, such payments will have to be made independently for each allocation.
- **Package preparation and customization:** STAWRS submission package will be customized at least to the extent to which wage-related returns are customized today. Paper submission packages will be pre-labeled with employer entity and identification numbers, and employer-specific tax rates. Additional customization where possible, such as SSN and name controls for known employees, would be included and will reduce taxpayer burden (e.g., for small paper form filers). For telephone and online PC filers, similar customization would be provided. Packages would also be provided in various languages so as to assist the non-English speaking employer.

Processing Returns and Payments

The steps performed by STAWRS in processing of remittances and wage and tax reports are essentially the same as those currently used today by each of the agencies involved in wage reporting and tax processing activities. These steps include:

- Mail processing (which in the STAWRS case includes receipt of electronic submissions)
- Remittance processing of paper checks, electronic fund transfers, and credit card payments (including balancing and deposit operations)
- Data capture (which will use the latest technology in automated character recognition) and preparation of electronic and magnetic media submissions for processing
- Data edit and perfection to assure accurate data capture
- Data storage and data base management for suspense case resolution and maintaining STAWRS data stores
- Archiving of original submission for the time period and in a form conducive for litigation purposes, taking into account the longest statute period of the participating agencies
- Processing unpostable conditions (especially employer and employee entity errors), thus reducing the need for each participating agency to separately contact the employer
- Processing of employer-submitted amendments and agency-generated adjustments to any employer accounts and wage records maintained by STAWRS

Data Retention and Distribution

Data processed through STAWRS will be provided to the participating agencies on media and in the format needed by the agency. This may include tape distribution, electronic data distribution, or controlled online access to data maintained by STAWRS.

Data retained by STAWRS will depend on the scope and functionality of the program, as well as legal/regulatory requirements of the participating agencies. For example, if STAWRS is to send out integrated submission packages, it will need, at a minimum, the name, address, and identification number of the employer. If STAWRS is to further customize such packages, it must maintain data on filing requirements and employer-specific

tax rates (e.g., UI experience rating), and, possibly, a list of current employees. If STAWRS is to validate and correct employer and employee entity errors, it must maintain related entity data. If account-specific employer assistance is to be provided, it must at least maintain data on payments and liabilities, and possibly on wage records and employee taxes. If STAWRS is to provide data services and processing support for claims- and compliance-related activities carried out by the participating agencies (see the following discussing of claims and compliance support), it must maintain data on most everything that it processes. Table 4-3 presents a summary description of these data stores. Access to these data stores will be strictly controlled to maintain security and privacy of these data. (Security and privacy are extremely important issues affecting STAWRS implementation and are discussed further in Section 6 of this document.)

Compliance and Claims Processing Support

It is not intended that STAWRS directly perform any compliance-related activities currently carried out by the Federal or state agencies that may participate in the WRSP. Nor is it envisioned that STAWRS will maintain data related to beneficiary claims and benefits administration.¹ However, to the extent that STAWRS maintains data needed to support these activities, data maintained by STAWRS may be used for such purposes under appropriate privacy, non-disclosure, and security constraints. Such activities may include employer tax compliance, employer UI compliance, employee tax compliance, SSA claims processing, and UI claims processing. Multi-state data needed, for example, by a UI claims processor to process an inter-state or agent-state claim would be available online from STAWRS. Similarly, identification of potential delinquent employment tax returns could be carried out using STAWRS data. Current IRS and state underreporter and questionable refund programs could be carried out with STAWRS data in a more timely fashion than at present.

Data maintained in STAWRS must be kept accurate. Thus the capability will be provided for updating returns data through the processing of amended returns, for recording adjustments resulting from examinations and audits carried out by participating agencies, and for disseminating or retrieving corrected data by authorized participating agencies.

The extent of such compliance support is primarily a function of legal and regulatory concerns of the participating agencies and their associated governments.

¹ The one exception to the latter is the possibility that STAWRS will provide for the ability of UI agencies to mark a specific reported wage record as having been used by a state as a basis for paying UI benefits.

Table 4-3
Examples of STAWRS Data Stores and Data Store Content

Major STAWRS Data Stores	Example Data Store Content
Employer entity and related information	<ul style="list-style-type: none"> • Name and address(s) • Identification number(s) and identification cross-references • Contacts for specific tax and filing purposes (e.g., payroll department, representative for tax matters) • Business classification(s) • Filing requirements and employer-specific rates
Employee entity and related information	<ul style="list-style-type: none"> • Name(s) and SSN • Employer/employee cross-references • Employee special classification for claims and compliance purposes
Employer tax liabilities	<ul style="list-style-type: none"> • Wages paid in each taxing jurisdiction in filing periods subject to withholdings, FICA, Medicare, and special state tax programs • Associated tax liabilities
Employer tax payments	<ul style="list-style-type: none"> • Payments made • Allocations of payments to participating agencies
Employer UI liabilities	<ul style="list-style-type: none"> • Wages paid in each state in filing period subject to UI taxes • Associated UI tax liabilities
Employer UI payments	<ul style="list-style-type: none"> • Payments made • Allocations of payments to participating states
Employee wages, tax, and withholdings	<ul style="list-style-type: none"> • Wages paid in each jurisdiction, tax class, and reporting period • Withholding for each jurisdiction and reporting period • FICA, Medicare, and special taxes paid on behalf of employee • Identification of related employer
Employee UI wages	<ul style="list-style-type: none"> • Employee UI wages paid • Identification of state wages paid in • Identification of related employer

4.2 WRSP LEVELS ANALYZED

To carry out the benefit cost and impact analyses of implementation of WRSP, three alternative WRSP concepts have been defined and referred to as Level 1, Level 2, and Level 3. Each concept embodies different WRSP scopes and different levels of functionality. Figure 4-2 provides a base diagram which identifies the full range of potential WRSP scope and functionality defined in the previous section. WRSP scope and functionality for Levels 1, 2, and 3 are described in the following sections with the aid of this diagram.

4.2.1 Level 1 -- High Functionality With Wage Code Harmonization

As depicted in Figure 4-3, Level 1 is defined to encompass the full range of WRSP scope and functionality defined in Section 4.1. The scope and functionality of Level 1 provide the greater potential for employer burden reduction and address the full range of requirements of Federal agencies and the state revenue and employment security agencies. Wage codes will be harmonized to the maximum extent possible. Current filing data flows will be significantly modified as shown in Figure 4-4. The following summarizes the features of Level 1.

- Wage code harmonization would be emphasized, resulting in
 - Common definition of wage components
 - Significant reduction in the number of definitions of reportable wage
 - Common classification of employees and independent contractors
 - Coordination of filing periods and due dates
 - Institution of a single employer identification numbering system
 - Uniformity in filing procedures
 - Redesign and simplification of forms and extension of allowable reporting media
- STAWRS provides employer registration services and issues a single employer identification number for use in all filing and account-related employer services at the Federal and state level.
- Current Employer's Quarterly Federal Tax Return (Form 941) would be annualized and combined with the Employer's Annual Federal Unemployment Return (Form 940), Employer's Annual Tax Return for Agricultural Employees (Form 943), and the Transmittals of Income and Tax Statements (W-3).
- The Employer's Quarterly Federal Tax Return for Household Employees (Form 942) would either be annualized or filed as part of the Individual Income Tax Return (Form 1040).

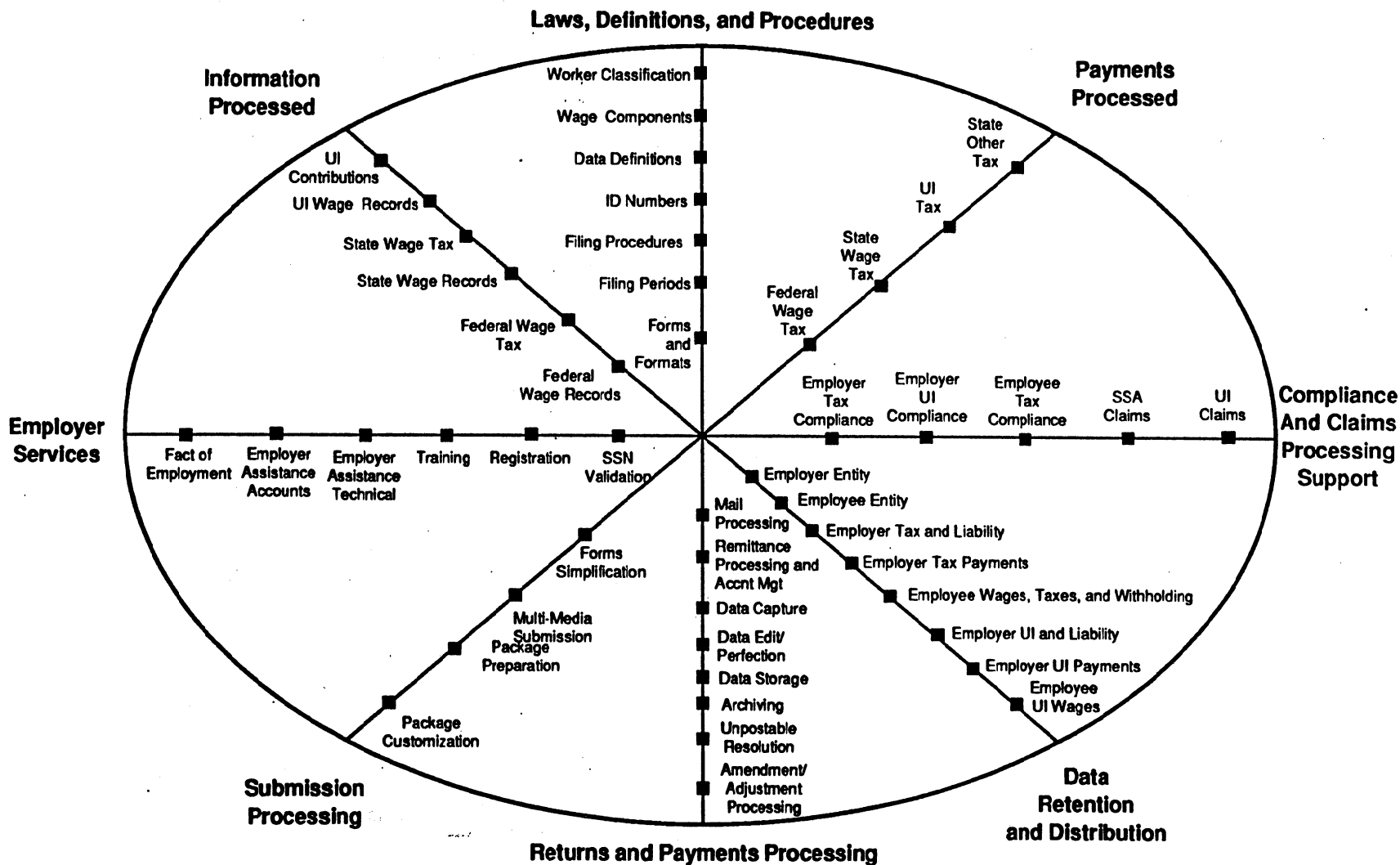


Figure 4-2
Range of Wage Reporting Scope and Functionality

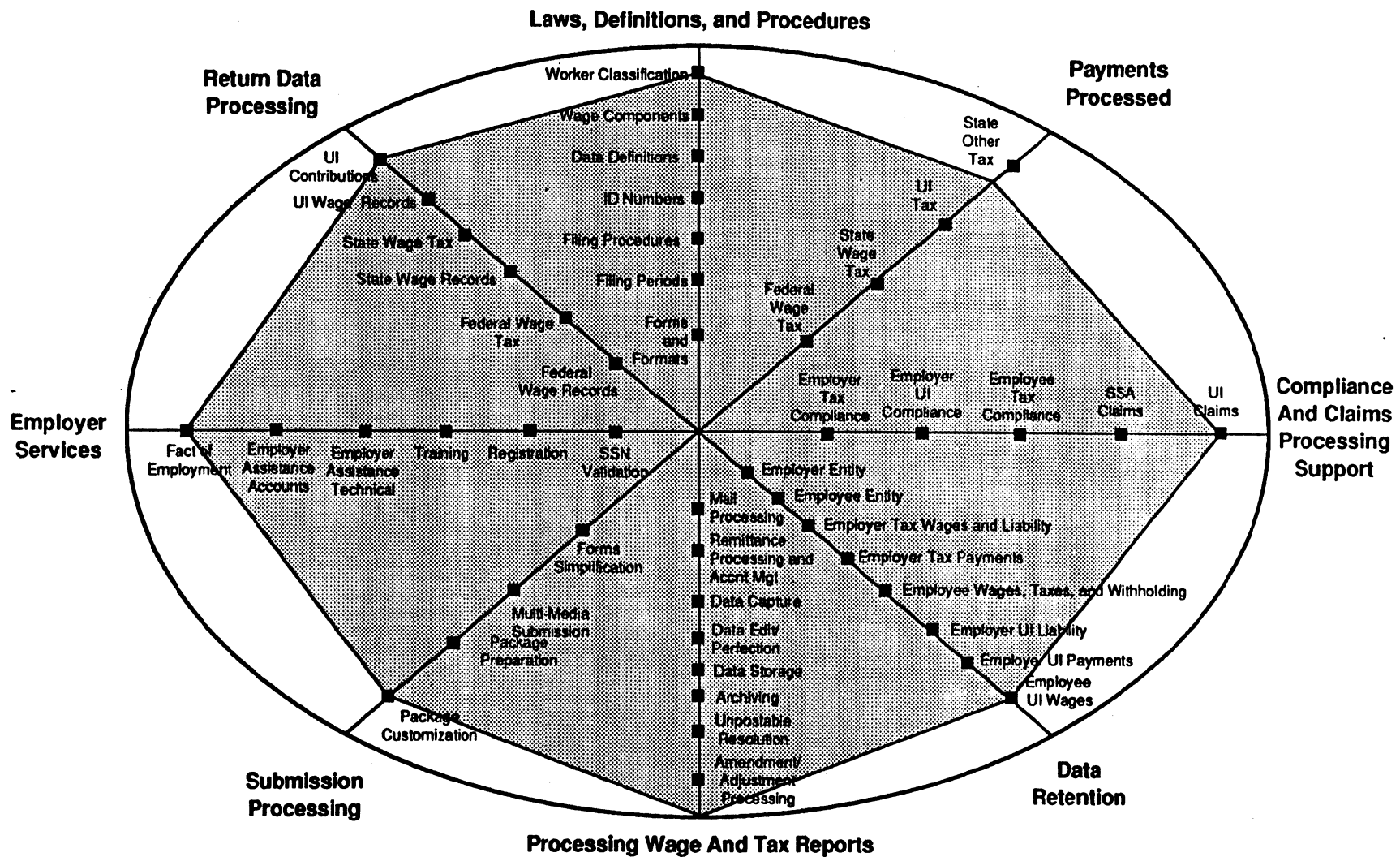


Figure 4-3
Level 1 Scope and Functionality

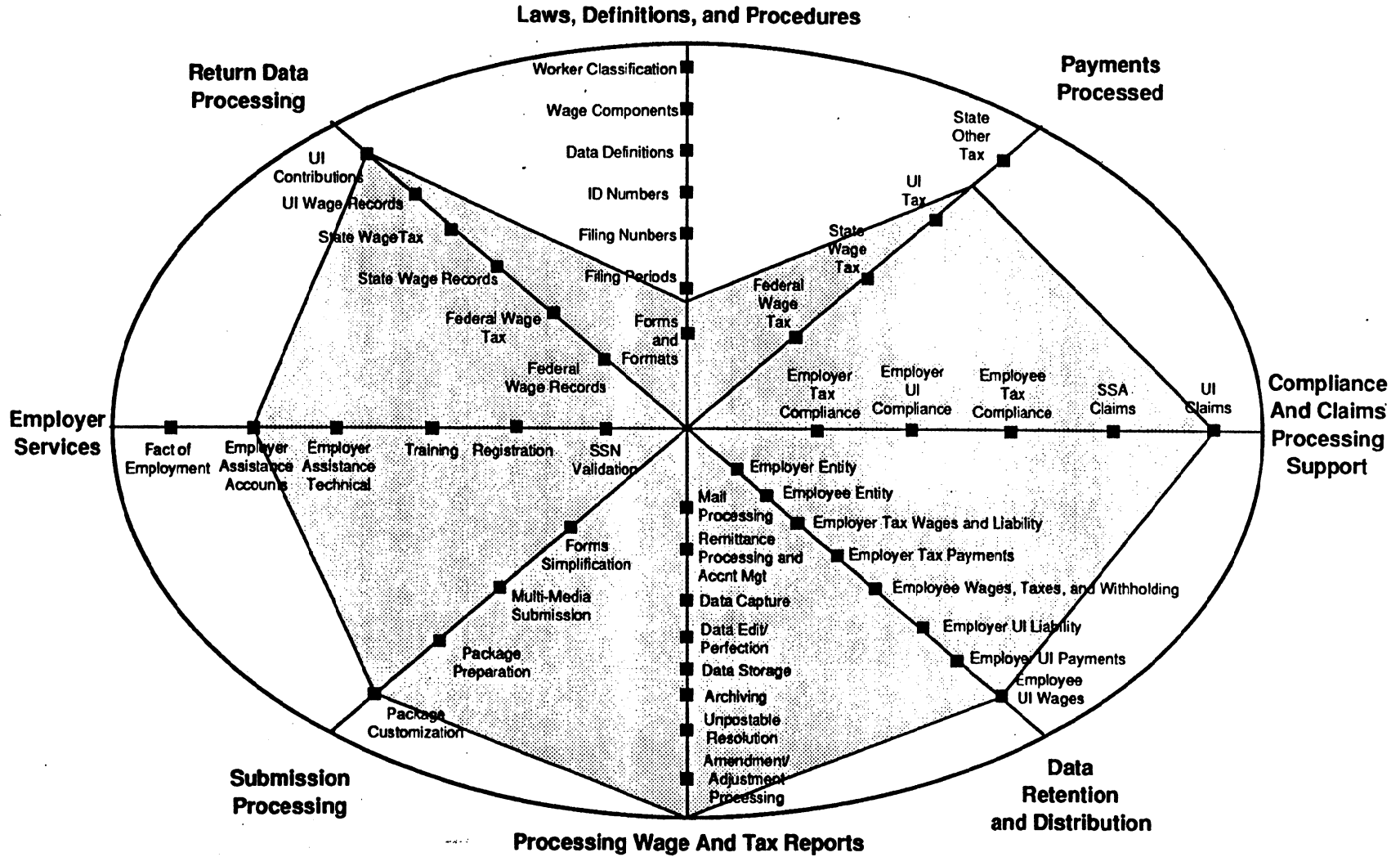
- State quarterly and annual withholdings and tax returns, and UI contributions reports would be combined with these Federal returns and also annualized.
- Payments would be combined and filed with a coupon which provides information on the allocation of payments by tax type and agency.
- All payments will be processed and deposited to agency accounts overnight from the date of receipt.
- Related payment schedules for tax and UI payments would be harmonized and would provide for a range of combined accelerated payment schedules similar to those used today for all classes of tax.
- An option is provided to the participating states for processing additional state tax payments such as sales and use tax, excise tax, and estimated business income tax payments.
- As a basis for tracking compliance, an alert system based on expected payments would be implemented, thus providing participating agencies with early warning of potential compliance problems.
- Four quarterly wage report submissions would be required
 - Three quarters containing UI wage data
 - The fourth quarter containing the fourth quarter UI data and annual data currently contained on the Federal and state Annual Wage and Tax Statements (W-2 or the state equivalent)
- All quarterly returns would be due one month from the end of the quarter.
- Returns would be fully processed and data available to support UI claims processing and tax compliance program within 60 days from the returns due date.
- All types of the employer services described in Section 4.1.2 would be implemented.
- Customization of submission packages will be provided along with all previously described media for returns and payment submission. An emphasis would be placed on electronic filing.
- Returns would be fully processed, and unpostable conditions resolved either via STAWRS in-house systems or via employer contact from STAWRS.

- STAWRS will maintain data stores to support all of its internal functions and to support claims and compliance activities of participating agencies.

4.2.2 Level 2 -- High Functionality With Little Wage Code Harmonization

Figure 4-5 depicts the scope and functionality attributes of Level 2. The scope of Level 2 includes the requirements of Federal agencies and state revenue and employment security agencies. Significantly less emphasis is placed on wage code harmonization. As in Level 1, current filing requirements will be significantly modified, as shown previously in Figure 4-4. The following summarizes the features of Level 2.

- Wage code harmonization would be limited to
 - Coordination of filing periods and payment due dates
 - Institution of a single employer identification numbering system
 - Redesign and simplification of forms
- STAWRS provides employer registration services and issues employer identification numbers (as needed) for each Federal and state (and agency) with which the employer intends to do business.
- Form 941 would be annualized and combined with Form 940, Form 943, and W-3.
- As in Level 1, a payment-based alert system for early identification of potential compliance problems is included.
- Form 942 would either be annualized or filed as part of Form 1040.
- State quarterly and annual withholdings and wage tax returns, as well as UI contributions reports, would be combined with Federal reports, and similarly annualized.
- As in Level 1, related payment schedules would be harmonized; payments would be combined and filed with a coupon which provides information on the allocation of payments by tax type and agency. All payments would be processed and deposited to agency accounts overnight from the date of receipt.
- All quarterly returns would be due one month from the end of the quarter and returns would be fully processed and data available to support UI claims processing and tax compliance program within 60 days from the returns due date.



**Figure 4-5
Level 2 Scope and Functionality**

- Except for recording fact-of-employment, all employer services described in Section 4.1.2 would be implemented.
- Customization of submission packages would be limited to employer-related information and employee-related information from the employers last filing.
- All media for returns and payment submission would be provided, and, as in Level 1, an emphasis would be placed on electronic filing.
- Returns would be fully processed, and unpostable conditions resolved either via STAWRS in-house systems or via employer contact from STAWRS.
- STAWRS will maintain data stores to support all of its internal functions and to support claims and compliance activities of participating agencies.

4.2.3 Level 3 -- Limited Functionality Without Wage Code Harmonization

Figure 4-6 depicts the scope and functionality attributes of Level 3. The scope of Level 3 is limited to Federal (IRS and SSA) requirements, and the annual wage and tax statement needs of the states (i.e., the state copy of the W-2). Other needs of state tax and employment security agencies are not addressed in Level 3. Wage code harmonization, employer services, and claims and compliance processing are not supported. The future environment for Level 3 is presented in Figure 4-7. The following summarizes the features of Level 3.

- As in Levels 1 and 2, current Form 941s would be annualized and combined with Form 940 and W-3.
- IRS would rely on its current FTD alert system for early identification of potential compliance problems.
- Form 942 would either be annualized or filed as part of Form 1040.
- Multi-media for submission of Federal tax filings and Federal/state annual wage and tax statements is provided. Paper returns are customized only to the extent of employer entity.
- State quarterly and annual withholdings and wage tax returns as well as UI contributions reports would not be processed by STAWRS.
- To support emerging IRS needs, the filing date for annual wage and tax reports (W-2) is moved to 31 January, and these reports are processed within 60 days of receipt.

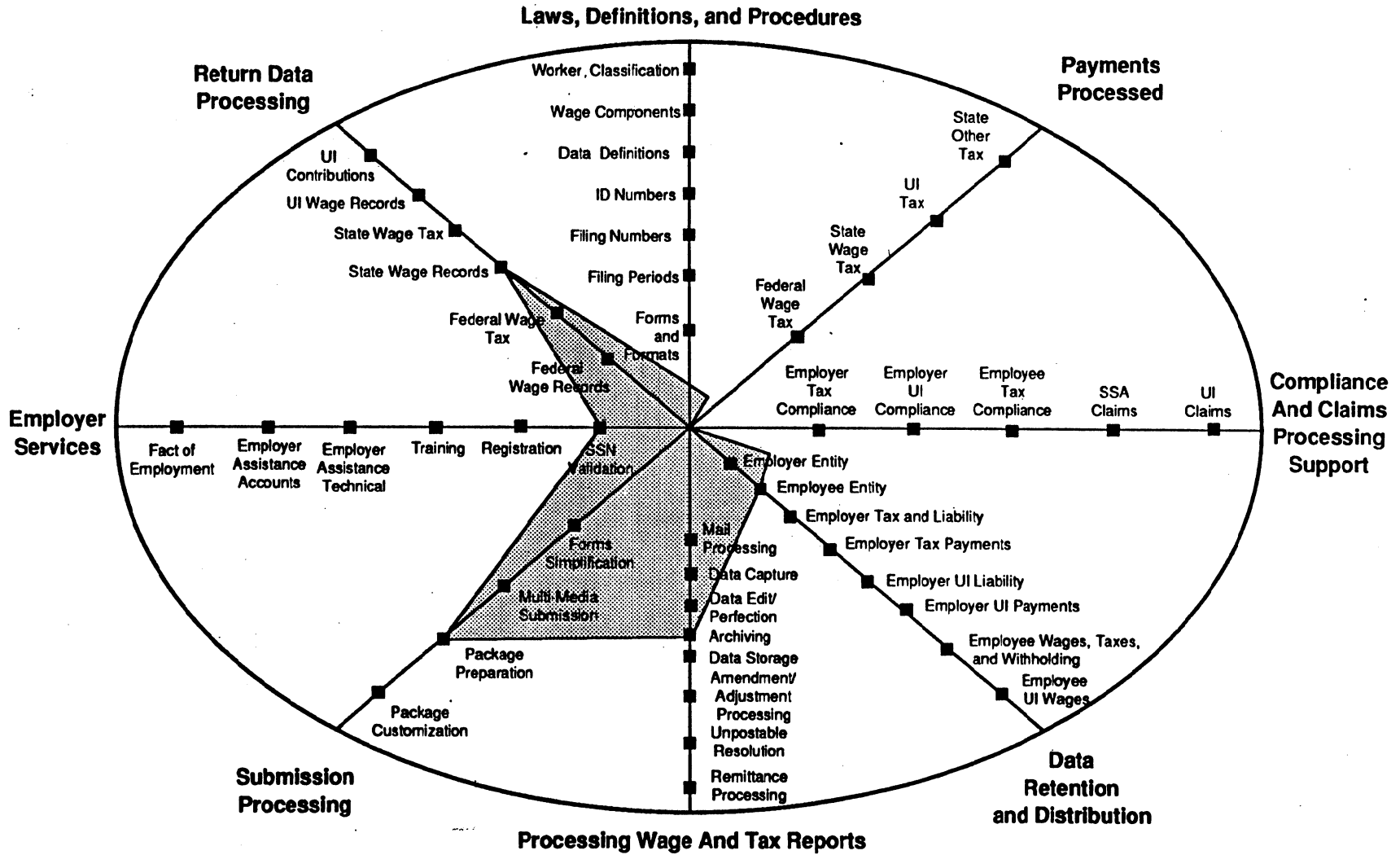


Figure 4-6
Level 3 Scope and Functionality

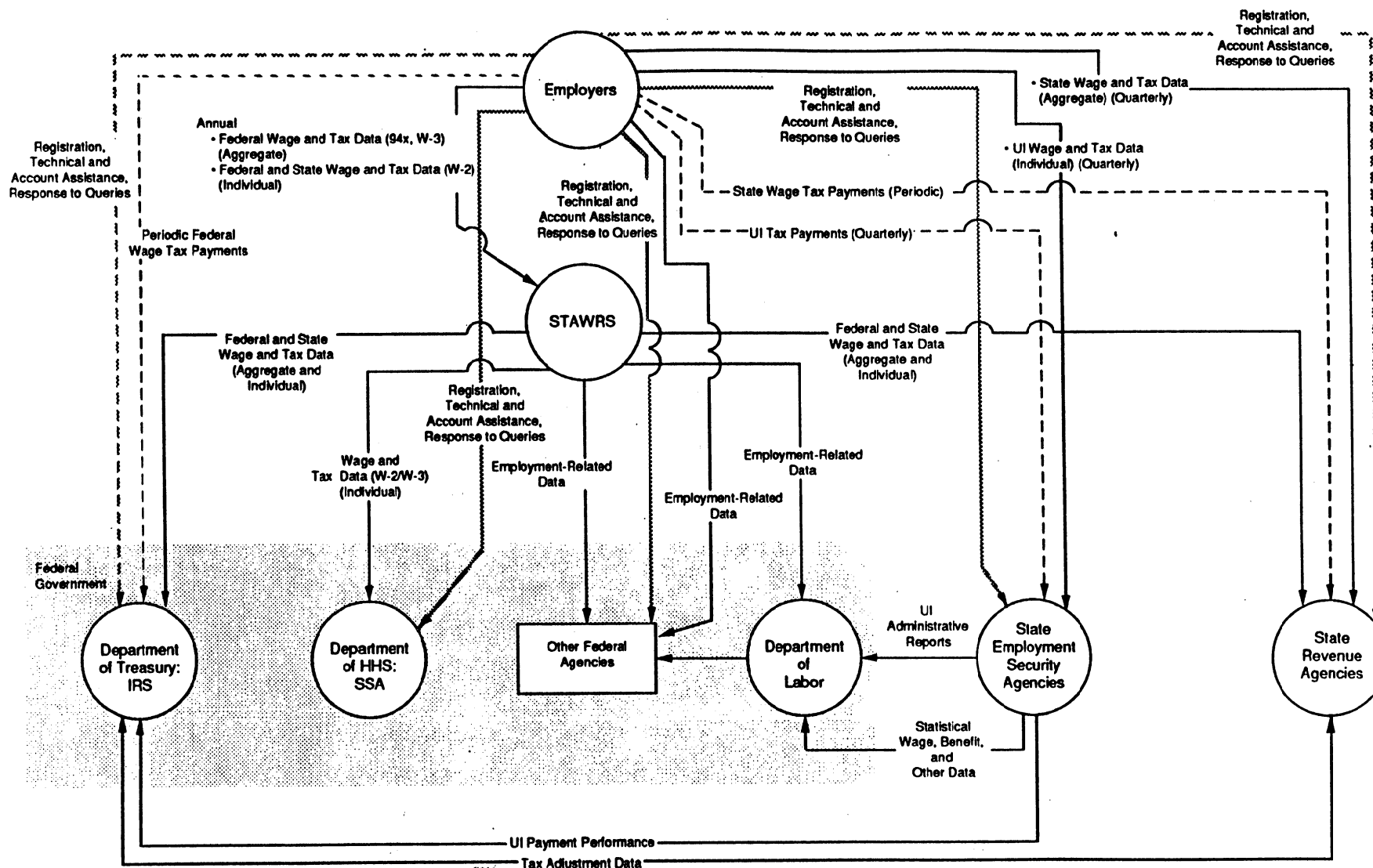
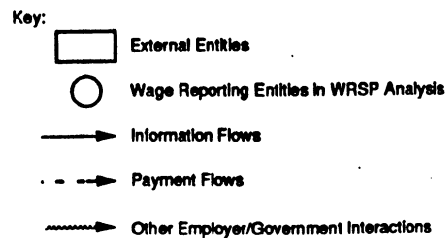


Figure 4-7
Future Environment for Level 3



- Payments are not processed through STAWRS.
- Except for SSN validation, no employer services are provided directly by STAWRS.
- Returns processing is limited to mail processing, data entry, and perfection.
- STAWRS will maintain only limited entity type data stores needed to prepare submission packages, and validate and correct, to the extent possible, employer and employee entities during returns processing.
- Data are distributed to participating agencies for unpostable resolution, storage, and maintenance.
- No claims processing or compliance support is provided.

4.3 TECHNICAL ARCHITECTURES

The alternative WRSP concepts (Levels 1, 2, and 3) provide three different levels of service to the employers and cooperating agencies who will use STAWRS. Each concept can be physically realized in a number of ways, both technically and organizationally. For the purposes of this feasibility study, technical architectures for each concept have been defined which represent, at a high level, a feasible way to implement the required STAWRS capabilities. These technical alternatives do not, at this point, represent a system design, nor do they represent the only way to build STAWRS for a given concept. Rather, the architectures verify the existence of a technically feasible approach to achieving the concepts. The technical architectures also provide a means for estimating the size, cost, and staff power required to acquire and operate each concept.

4.3.1 Assumptions and Constraints

The derivation of the technical alternatives for each of the concepts was bound by certain constraints and required a number of assumptions about the variables which affect the outcome of the analysis. The key constraints and assumptions are shown in Table 4-4.

Assumptions concerning the magnitude of future workloads are particularly critical, as the workload projections are a major determinant of the size and cost of each allowance. The technical alternatives were sized for the year 2008, the year in which the system will be fully mature. The future workloads were estimated from current workloads projected at assumed compound growth rates of employer and employee populations. The employer population grew from 4.8 million in 1981 to 6.0 million in 1990, a compound growth rate of approximately 2.5 percent a year. This rate was used to project workloads of employer

Table 4-4
Key Constraints and Assumptions in the STAWRS
Technical Alternative Development

Constraints/Assumptions
Constraints <ul style="list-style-type: none">• All current and planned functions conducted by the cooperating government agencies will be performed in the future.• The system architecture will be devised to use off-the-shelf solutions where feasible.• To minimize risks of underestimation of STAWRS costs, only proven, current generation technologies will be considered.
General Assumptions <ul style="list-style-type: none">• Other than the previously described features of wage code harmonization, there will be no major impacts on workload resulting from tax law or unemployment insurance law changes.• No major demographic or economic changes will occur which could affect future workloads.• Online retrieval of STAWRS entity, tax, wage, and administrative data is restricted to authorized STAWRS and user agency personnel.• Paper copies of tax returns and wage records will not be kept; however, images of all submissions will be made and archived for an indefinite period.

Table 4-4
Key Constraints and Assumptions in the STAWRS
Technical Alternative Development
(Concluded)

Constraints/Assumptions
<p>Hardware Assumptions</p> <ul style="list-style-type: none"> • The types of equipment considered are representative of currently available technology, technological breakthroughs, and major advances in device performance and cost reduction are not assumed. • Assumptions of technical performance (e.g., image storage resolution and compression ratio, optical character recognition success rates, scanner feed rate) are consistent with IRS's Tax Systems Modernization program assumptions.
<p>Telecommunications Assumptions</p> <ul style="list-style-type: none"> • Transmission of digital images of tax documents is not required. • A single network connection is provided to each cooperating government agency. It is not meant to supplant existing Federal or state networks. Each agency will bring its calls to a central point for interconnection with STAWRS. • Local area, backbone, and backend networks within the STAWRS facilities are included in sizing and costing, but no wide area network was sized.
<p>Performance Assumptions</p> <ul style="list-style-type: none"> • All components are sized to handle workloads projected for the year 2008. • All components are sized to handle peak processing demand. • Mainframe computer capacities allow for unanticipated growth and errors in workload estimation. • Disaster recovery and backup processing requirements are considered to be covered by the inclusion of a separate set of mainframe computers, direct access storage devices, and automated tape libraries which also serve the purpose of a program development/system acceptance testing system.

correspondence, telephone calls, withholding tax returns, unemployment tax and wage returns, and payment submissions in the year 2008.

In order to forecast employee-related workloads in 2008, a growth rate of slightly over 1 percent was used. This growth rate was based on IRS projections, and was used to project number of employee wage records, and Social Security and unemployment claims.

4.3.2 Technical Architecture for Levels 1 and 2

Because Levels 1 and 2 differ primarily by the inclusion of wage code harmonization in Level 1, but not in Level 2, the actual technical architecture for Levels 1 and 2 are topologically the same. A high-level view of the STAWRS technical architecture for Levels 1 and 2 is shown in Figure 4-8. The architecture consists of four main subsystems, which are termed facilities. These are as follows:

- User Service Facility
- Submission Processing Facility
- Data Management Facility
- Support Facility

User Service Facility

The STAWRS User Service Facility (USF) is the principal point of contact for the employer community. Employers or their agents are provided with one-stop service when they must deal directly with STAWRS. It also provides employer training and outreach services. Additionally, it serves as the point of contact for the cooperating government agencies. Major subcomponents of this facility include the following.

- Employer Advice, Service, and Education Center: Provides 'live' assistants to answer employer procedural, technical, and account inquiries. The staff take orders for publications and forms and handle the initial registration of new employers for all of the cooperating agencies. The center also proactively provides outreach services to employers.

New employers call the STAWRS staff on a toll-free line to request registration information. STAWRS staff check STAWRS data stores for existing registrations for this employer, and, as needed, enter employer information into STAWRS data stores during the telephone call.

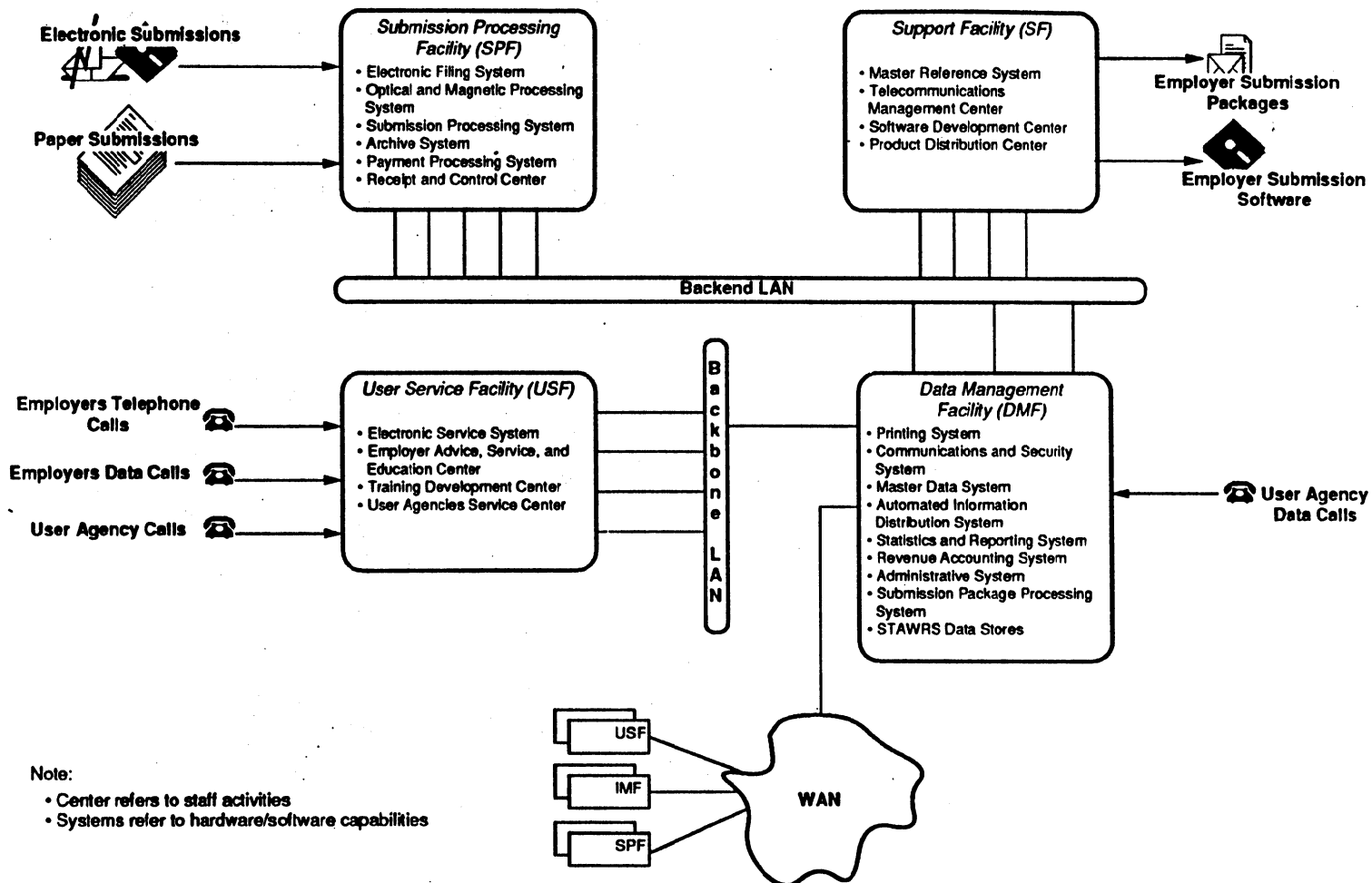


Figure 4-8
STAWRS Technical Architecture for Levels 1 and 2

Under Level 1, STAWRS prepares a partially completed combined Federal and multi-state registration form based on information provided by the employer and sends it with instructions and a Unified Identification Number (UIN) for the employer to use with all Federal and state agencies. Under Level 2, where states maintain the unique employer numbering systems which exists today, the same procedures are followed, but the employer is issued multiple identification numbers. In this latter case, STAWRS will have to maintain the data needed to validate unique state numbers.

- In addition to employer identification numbers, Personal Identification Numbers (PINs) such as those used with automatic tellers, or a system of secure digital signatures may be used to assure authentication for electronic submissions of returns and other electronic interactions with the STAWRS.
- Training Development Center: Prepares training materials (course materials, videos, brochures, etc.) for employers and for STAWRS staff. It also provides staff to conduct training courses and seminars in employment wage and tax matters.
- User Agency Service Center: Primary point of contact with the government user agencies; answers queries and take requests for service from designated user agency representatives.
- Electronic Service System: Supports the authorized USF staff access to STAWRS data needed to provide one-stop service to employers. In addition, with appropriate access control to assure security and privacy, it provides employers with a variety of electronic services, including telephone and computer filing, and access to bulletin boards and to a limited subset of the employers own account status data on a read-only basis. Such employer access is provided via telephone and voice response unit, or via computer and modem. Facsimile, electronic and voice mail services are available to callers when the facility is closed.

The USF staff are connected to a file server within the USF which supports case work, and are connected to the Master Data System where the wage and employment tax data stores are kept. This arrangement allows the assistors to retrieve employer account data (e.g., payments, payment allocations to participating agencies, reported tax liability, etc.) in realtime, while the employer is on the telephone. Account data can also be downloaded in realtime to the Electronic Service System (ESS) processor to service employer telephone and computer requests for account status. Individual state benefit charges for reimbursable accounts may also be processed through STAWRS. If this is found to be workable, related account data for reimbursable UI accounts would be made available to STAWRS from state UI agencies and thus available to STAWRS assistors.

Submission Processing Facility

The second major STAWRS subsystem is the Submission Processing Facility (SPF) which receives and processes all paper, electronic, and magnetic media submissions of employment tax returns, registration forms, change of status forms, wage reports, and payments. The SPF is also the point of contact with employers for TIN validation and fact of employment recording.

The SPF contains the equipment and human resources needed to process all incoming documents and payments. Its primary components are the following:

- **Submission Processing System:** Processes paper submission using optical scanning and character recognition techniques
- **Remittance Processing System:** Processes direct payments and advice of credits from depository banks and the automated clearing house for electronic funds transfers
- **Electronic Filing System:** Handles electronically filed returns, telephone filed returns, and TIN validation

These systems are attached to the Master Data System via the backend local area network (LAN).

Data Management Facility

Operationally, the most important of the STAWRS major subsystems is the Data Management Facility (DMF). Its prime purpose is to store, safeguard, and make available to authorized users, the wage data and tax account information collected from employers. Its major assets are several large mainframe computers, peripheral storage devices, and high-speed printers. The system also functions as the administrative processor for STAWRS. Further, it provides statistical and management reports and performs the charge-back and revenue accounting tasks of STAWRS. The major components of this facility are the Master Data System, the STAWRS Data Stores, and the Communications and Security System. Five other systems complete the full set of components for this facility.

- **Master Data System and STAWRS Data Stores (see Table 4-3):** Provides for user agencies which furnish workstations and terminals to allow authorized users to logon to the STAWRS Master Data System and to query the STAWRS data bases online over a nationwide telecommunications network. Most non-STAWRS staff are limited to read-only access, but some are authorized to enter data and amend records.

Data can be downloaded to authorized user file servers. User agencies use a nationwide telecommunications network to download data and reports.

STAWRS has a single logical integrated employee data store for all employee wage records. This eliminates the need for separate systems to process inter-state combined wage, agent state, and Federal UI claims.

Access and use of data complies with all limitations implied by law, regulation, and procedures of the participating agencies.

- **Communications and Security System:** Ensures that data are not disclosed to unauthorized parties or allowed to be corrupted. STAWRS includes system security and access control capabilities necessary to ensure the privacy and confidentiality of the employer-submitted information and to avoid unauthorized disclosure, modification, or loss of STAWRS data.

Automated data processing (ADP) hardware safeguards include automatic shutdown and protection of components, preventative and restorative maintenance, hardware configuration management, hardware intrusion protection devices, challenge response cards, address chips, and encryption devices. ADP software safeguards include routine data backup and archiving; virus detection; software configuration management; trusted operating systems; auditing of all transactions and continuous journaling; development and use of user profiles and access controls; password and PIN management; key management; encryption of digital signatures, telecommunications and special sensitive stored data; object reuse; automatic logoff of workers; use of training versus operating mode for new employees; separation of roles; and a secure software development and distribution process.

- **Other components**
 - **Cost Accounting System:** Gathers information on the use of all STAWRS resources by participating user agencies. This system capability is used to prorate the cost of STAWRS across all user agencies.
 - **Workload Scheduling and Allocation Capability:** Supports detailed control and short-term planning of all STAWRS operational decisions, including workload planning, capacity management, and staff management.
 - **Administrative Reporting System:** Provides managers from STAWRS and participating agencies with complete information on STAWRS operation and status.

- Statistical Sampling and Reporting System: Provides data on employer and employee wage activities. The statistical summary reports will be designed to support the wage and related data requirements of participating state agencies, SSA, DOL Employment Training Administration, DOL Bureau of Labor Statistics, and IRS Statistics of Income. STAWRS has the capability to perform the range of data manipulation and mathematical analysis required to provide sound and useful sampling statistics.

Support Facility

The last of the four STAWRS subsystems is the Support Facility. It primarily provides services to STAWRS itself with one notable exception, the Product Distribution Center. This center provides employers with submission packages (returns, payment coupons, and instructions) and interface software for electronic filing or to access the STAWRS bulletin board. It also provides the interface software required by the cooperating government agencies to access the STAWRS data stores. The Support Facility houses the STAWRS Software Development Center which develops and maintains STAWRS software. It has complete program development and test capabilities including spare suites of equipment which also serve as a backup to the Master Data System and processing components of STAWRS. This facility has the following important components.

- Telecommunications Management Center: Monitors and manages the internal STAWRS LANs and communications assets. It also arranges for the commercial services which are used by STAWRS to communicate with its employer and user agency clients.
- Master Reference System: Provides operating procedures, rules, regulations, wage codes, and other reference materials needed by the STAWRS staff to operate the system, and provide one-stop employer assistance.
- Product Distribution System: Sends Federal/multi-state combined submission packages to employers which contain all materials necessary to file employment tax returns, report employee wages, pay taxes, notify STAWRS of status changes, and contact STAWRS. An employer can request his submission package in paper form or on magnetic media.

A key aspect of Support Facility activities is to maintain the standards used for all user interfaces with STAWRS. Such standards include, among others, open systems interconnection and application portability profiles which will allow both government and third party produced software and telecommunication products to maintain interoperability.

4.3.3 Technical Architecture for Level 3

WRSP Level 3 is a much scaled-back version of the alternative WRSP concepts. The scope of Level 3 is limited to Federal (IRS and SSA) requirements, and the annual individual wage and tax statement needs of the states. It does not process tax returns and payments, or state UI returns, wage reports and payments. It does not retain data, provide account access, support compliance activities, or support claims processing.

Figure 4-9 shows the technical architecture for Level 3 by indicating the principal changes to the technical architecture for Levels 1 and 2. The Payment Processing System, the Training Development Center, the Statistical Reporting System, and the Revenue Accounting System are eliminated. While many parts of the workload are reduced, some of the hardware components are essentially unaffected. The Submission Processing System in Level 3 is about as large as in Levels 1 and 2 because the annual combined Form 94x/W-3/W-2/state individual wage statement workload is just as large; however, the system remains idle most of the year. The Electronic Filing System decreases only modestly in size due to the elimination of processing electronic FTDs, but the TIN validation workload remains.

The USF telephone equipment (automatic call distributor, voice response unit, and telephones) is substantially reduced, but the modem pool and voice response unit remain about as large to support access to tax topics through its TeleTax-like and bulletin board capabilities.

The Master Data System shrinks in processor capacity, with its major workloads being data distribution to the cooperating agencies and printing of the annual submission packages.

4.3.4 Architectures Summary

The technical architectures described represent feasible implementations of Levels 1, 2, and 3. As stated earlier, they are not a system design which would be produced as a result of a detailed requirements analysis. They also have not taken into account site-related considerations such as the number, size, and location of specific processing sites. Rather, they were developed to support the objectives of the feasibility study by providing a basis for estimating the size, cost, and staffing necessary to implement each alternative WRSP concept.

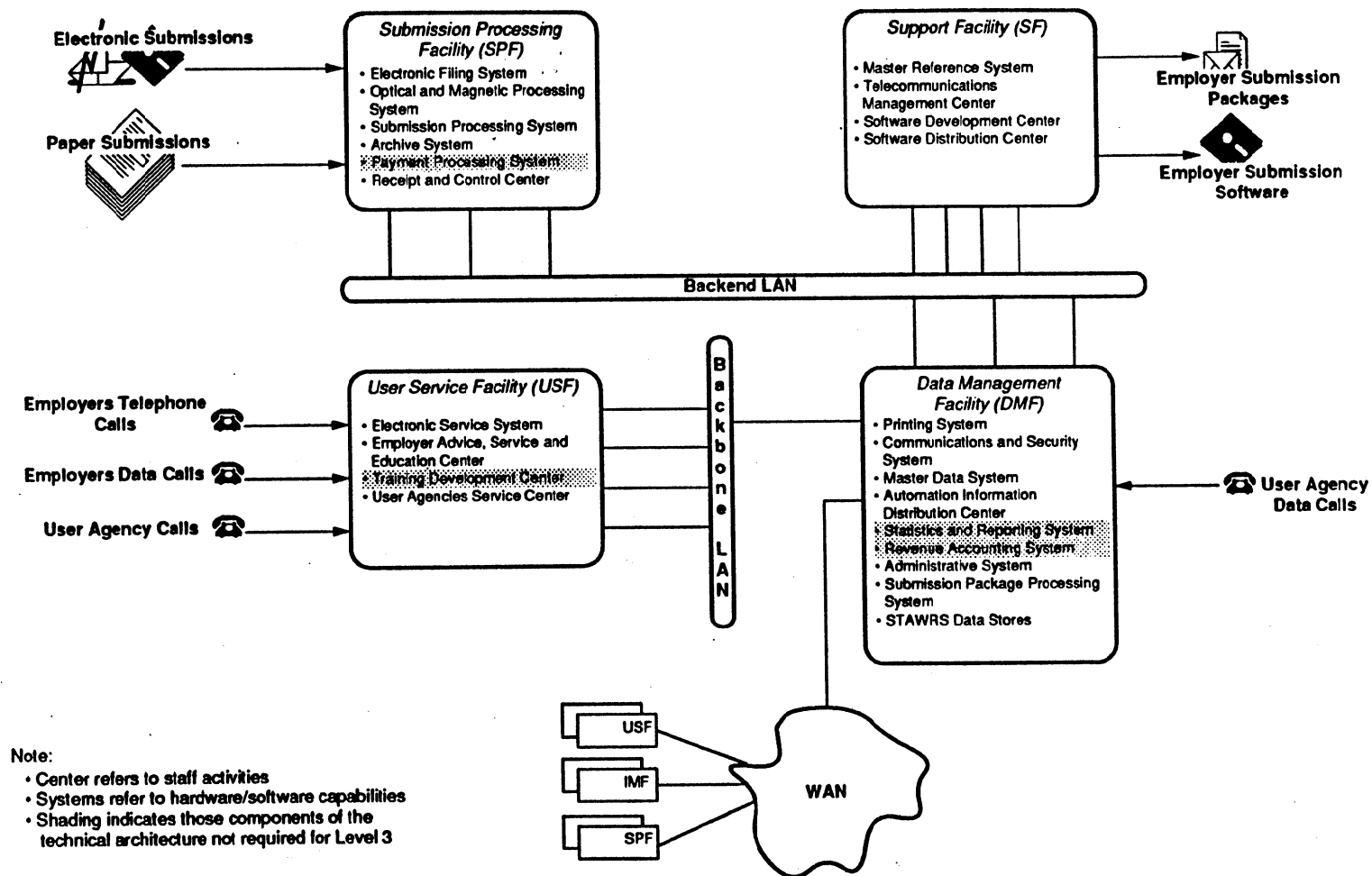


Figure 4-9
STAWRS Technical Architecture for Level 3

SECTION 5

INITIAL ECONOMIC ANALYSIS

5.1 SUMMARY

A major aspect of the assessment of the feasibility of implementing any wage reporting simplification alternative concept is determining the economic viability of that concept. This viability is dependent on the difference between the costs to implement and operate the system, and the benefits which accrue from implementing the system. Given the objectives of WRSP (to reduce employer burden while maintaining or improving government program operations), benefits were defined in this analysis to include the following:

- Reduction in employer burden, measured as a reduction in costs associated with activities in the four burden categories (defined in Section 3) related to complying with Federal and state filing and payment requirements
- Reductions in government functional operations costs resulting from implementing a given alternative WRSP concept measured as the difference between cost of current operations and operations under WRSP
- Increases in revenues from associated compliance activities -- this type of benefit is not easily monetized, and is addressed only in a qualitative assessment in this analysis

Costs associated with each alternative WRSP concept were defined in three categories:

- System (i.e., STAWRS) costs: Costs of acquisition of system hardware, software, and other resources; and costs for hardware and software operations and maintenance (O&M)
- Government transition costs: Costs to the government to transition to the new operation (e.g., cost of converting software to interface with the new STAWRS software)
- Employer transition costs: Costs for the employer community to transition to the new operation

Three primary measures of the differential between costs and benefits for an alternative WRSP concept are used in this analysis; these are the benefit-to-cost (benefit/cost) ratio, the

net value (benefits less costs, both in constant dollars and in present value dollars¹), and the break-even point (the time required for the cumulative benefits to exceed the cumulative costs). The estimates of these measures from the economic analysis of the three WRSP levels are shown in Table 5-1. All three WRSP levels have a benefit/cost ratio greater than 1.00 and positive net values, both in constant and present value dollars. For Levels 1, 2, and 3, benefit/cost ratios are 5.04, 2.73, and 2.05, respectively. Since Levels 1 and 2 have essentially the same costs, the greater benefits estimated for Level 1 give it a significantly larger benefit/cost ratio. Level 3, which is the lowest cost level, also has the lowest (although still greater than 1) benefit/cost ratio due to the reduced benefits anticipated.

All three WRSP levels have positive net values ranging from \$12.9 billion (constant dollars) for Level 1, to \$6.0 billion for Level 2, to \$1.3 billion for Level 3.

All three WRSP levels also have a break-even point in the middle of the STAWRS economic lifetime. The assumed economic life used for this analysis is 1994 through 2008, based on the expected equipment life. The estimated cumulative annual costs and benefits for Levels 1, 2, and 3 (measured in present value dollars) are shown in Figure 5-1. All WRSP levels analyzed have a payback period of less than four years from the assumed start of phase-in operations.

The life cycle analysis reflects a phased implementation of each level, followed by approximately seven years of operation at full implementation. A gradual increase to 100 percent state participation was incorporated in the analysis. The following general assumptions were also made.

- This Phase I analysis does not take into account any organization-specific allocation of STAWRS functionality or site specificity. Thus, existing or planned capabilities of potentially participating agencies, Federal or state, are not taken into account. Such organizational refinements are to be carried out as part of Phase II of the feasibility study.

¹ Constant dollars are computed values which remove the effect of inflation over time. An estimate is said to be in constant dollars if costs for all work are adjusted so that they reflect the level of prices of a base year. Present value dollars are the estimated current worth of future benefits or costs derived by discounting the future values, using an appropriate discount rate. In this section, present value dollars are used in calculating benefit/cost ratios and economic break-even points. All other dollar estimates are in 1992 constant dollars.

Table 5-1
Costs and Benefits Summary, 1994 - 2008*

	Level 1	Level 2	Level 3
COSTS	2,230	2,230	810
STAWRS Acquisition and Operations and Maintenance	1,100	1,100	430
Government Transition	50	50	20
Employer Transition	1,080	1,080	360
BENEFITS	15,130	8,240	2,160
Government Reduced/Avoided Costs (Government Baseline Costs Savings Less STAWRS Offsetting Costs)	1,660	1,490	530
Employer Burden Reduction	13,470	6,750	1,630
NET VALUE (Benefits Less Costs)	12,900	6,010	1,350

	Level 1	Level 2	Level 3
COSTS	1,350	1,340	510
BENEFITS	6,790	3,660	1,040
NET VALUE (Benefits Less Costs)	5,440	2,320	530
BREAK-EVEN POINT	Year 2000	Year 2001	Year 2001
BENEFIT/COST RATIO	5.04	2.73	2.05

* Constant dollars (in millions)

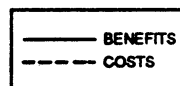
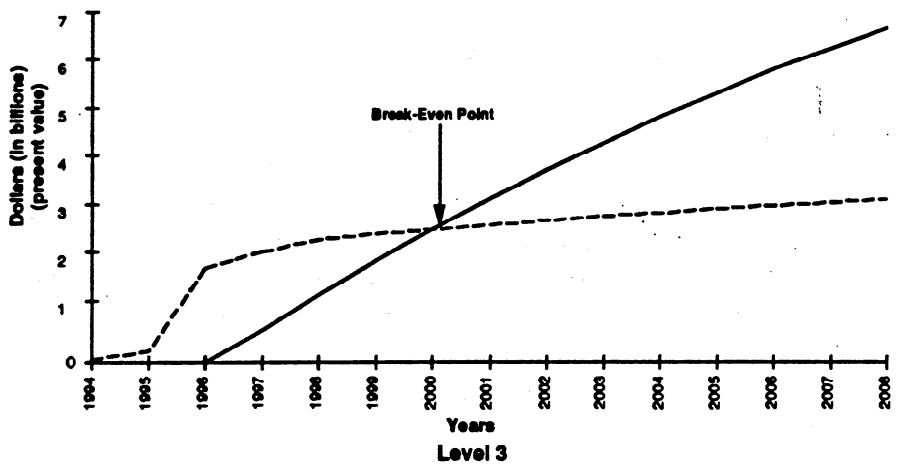
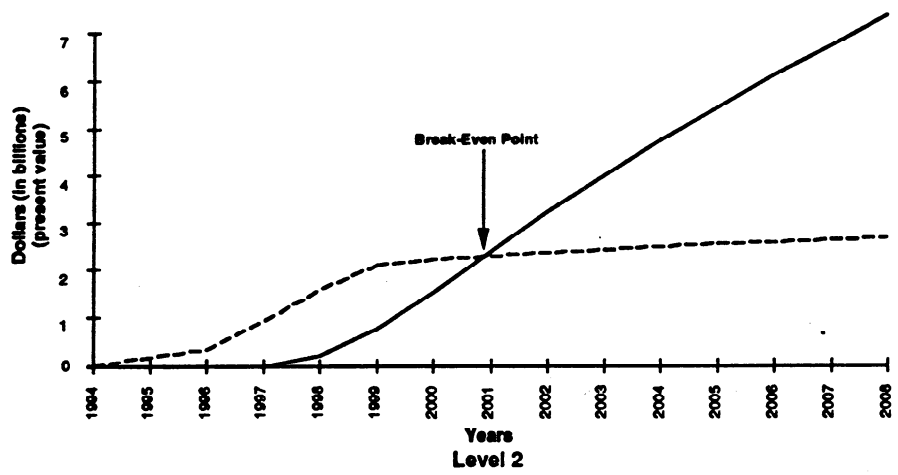
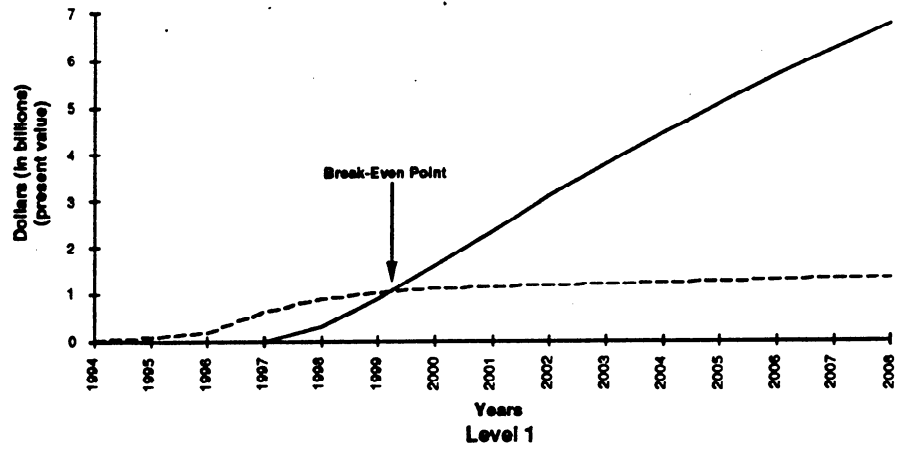


Figure 5-1
Cumulative Costs and Benefits by Year for WRSP Levels

- The analysis does not assume a specific processing environment -- either centralized or distributed
- Cost estimates are in 1992 dollars; present value analyses are discounted at 7 percent per year (as per OMB Circular A-94 - revised October 1992)
- Direct STAWRS labor is calculated in terms of full time equivalents (FTEs); there is no delineation between part-time and full-time employees

Additional assumptions and methodology for estimating costs and benefits are presented later in this section.

In addition to the monetized benefits, each of the alternate WRSP concepts analyzed will contribute, to a different degree, to several important non-monetized tax processing and operational factors. Table 5-2 qualitatively summarizes these potential benefits. Level 1, due to the harmonized wage code, may be expected to reduce barriers to formation of new businesses and to interstate business expansion -- an important concern to employers and government. Primary concerns to government agencies include potential improvements in many compliance programs made possible through improved access to tax and wage information, improved data accuracy, improved data timeliness, and more extensive data reconciliations and cross-matching activities. The degree to which the latter are implemented depends to some extent on legally permissible data use and data exchange. These issues are addressed in detail in Section 6 of this document. In addition to the direct compliance efforts implemented with the aid of STAWRS data, it may be expected that voluntary compliance at both the Federal and state level will also improve. At the Federal level, a rough estimate is that a 1 percent gain in voluntary compliance results in an additional \$6 billion in revenue. Little, however, is known definitively of the relationship between direct compliance efforts and levels of voluntary compliance.

5.2 BENEFITS OF THE ALTERNATIVE WRSP CONCEPTS

Within the benefits category, Levels 1, 2, and 3 show significant reductions in employer burden and government operations costs. The reduction in employer burden for Level 1 is estimated at \$13.5 billion (constant dollars) over the program's economic life and is significantly greater than the reduction estimated for Levels 2 and 3. The implementation of the harmonized wage code is an integral part of Level 1 and approximately half of its total burden reduction estimate is attributed to its inclusion. In addition, a government reduced/avoided cost is expected to accrue to the participating agencies for Levels 1, 2, and 3. For this analysis, reduced costs are considered to be reductions in current functional operating costs (primarily the costs of processing returns and payments and providing employer

Table 5-2
Examples of Potential Non-Quantified Benefits

Potential Benefit	Level 1	Level 2	Level 3
Reduced barriers to formation of new businesses and interstate/multi-site business expansion	High	Low	Low
Decrease in Federal and state unreported individual income	High	High	High
Reduction in erroneous Federal and state individual income tax refunds	High	High	High
Improved identification of Federal and state individual income tax non-filers	High	High	Moderate
Easier access to data for interstate or agent state UI claims processing	High	High	Not Applicable
Reduced payment of SSI claims to non-qualified individuals	High	High	Not Applicable
Reduced payment of state administered welfare benefits to non-qualified individuals	High	High	Moderate
Improved reconciliation of withholding paid to withholdings reported on individual wage reports	High	High	High
Improved identification of potential UI non-filers	High	High	Not Applicable
Improved identification of potential Federal and state withholding tax non-filers	High	High	Moderate
Improved ability to locate delinquent child support providers, and other statutory debtors	High	High	Low
Improved employment-related statistical data	High	High	Low

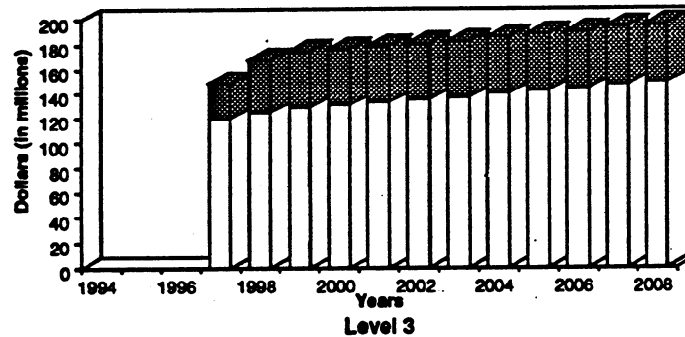
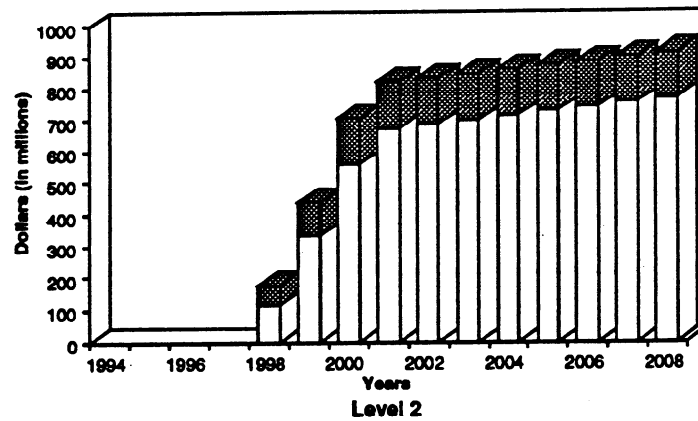
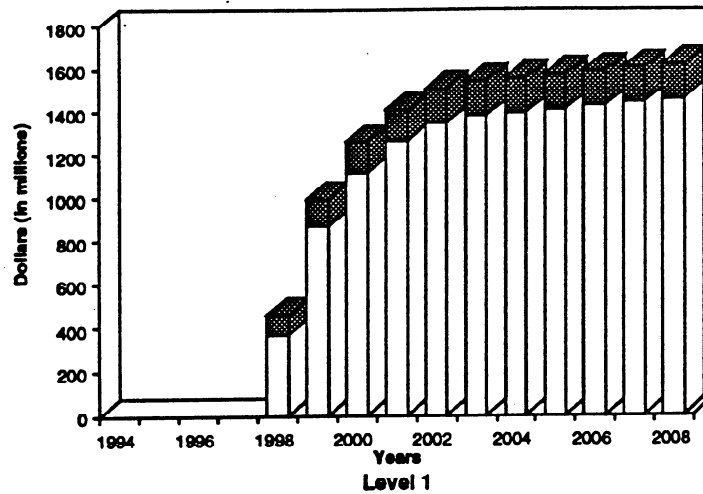
assistance), whereas cost avoidance is defined as those additional costs which are not incurred for the incremental increases expected in workload growth.

The annual² benefits estimated for Levels 1, 2, and 3 are shown in Figure 5-2. The employer burden reduction benefit starts to accrue on a limited basis during the first year of operation (1997-1998 for Levels 1 and 2, and 1996-1997 for Level 3) and continues to build as state participation increases. In each case, it is assumed that full state participation is achieved. Full state participation is projected to occur within five years for Level 1, within four years for Level 2, and within three years for Level 3. At full implementation, the annual employer burden reduction is estimated at over \$1.5 billion (constant dollars) for Level 1; over \$770 million for Level 2; and \$150 million for Level 3. If full state participation is not reached, the total benefits achieved will be reduced by the approximate proportion of the employers/employment population covered by the program. Table 5-3 depicts the sensitivity of total life cycle benefits to level of state participation.

5.2.1 Employer Burden Reduction

In relation to the other benefits, the reduction in employer burden is clearly the largest factor. Figure 5-3 shows for a typical year of employer burden reduction at full implementation, how this employer burden reduction varies across the three WRSP levels analyzed, and how it varies across the four employer burden categories defined in Section 3 of this document. For Level 1, almost half of the \$1.5 billion (constant dollars) annual burden reduction is attributed to the reduced cost of finding, understanding and implementing provisions of wage reporting laws and regulations. Nearly 30 percent of the burden reduction is attributable to reduced record keeping. The harmonized wage code and extensive employer services included under Level 1 are the key contributors to this effect. For Level 2, which does not have a harmonized wage code, nearly 60 percent of the \$770 million annual employer burden reduction is attributed to reduced requirements tracking due primarily to the significant STAWRS employer assistance functions. The remaining employer burden reduction is equally split between submission and responding to government queries. For Level 2 there is relatively little impact on the record keeping burden. For Level 3, approximately 70 percent of the substantially smaller \$150 million of annual employer burden reduction is attributable to reduction in submission processing activities, and about 25 percent to reduction in burden associated with responding to government inquiries.

² The year-by-year displays of costs and benefits are not based on a formal implementation plan. Such a plan will be developed in a subsequent phase of the program. These displays were constructed to give a sense of the sequencing of expenditures and benefits and to provide the basis for present value analysis and benefit/cost ratio calculations.



Note: Scales are different

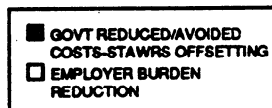


Figure 5-2
Annual Benefits for WRSP Levels

Table 5-3
Sensitivity Analysis -- State/Employer Participation*

Costs	Level 1	Level 2	Level 3
Benefit/Cost Ratio			
As Calculated	5.04	2.73	2.05
Less Aggressive Phase In	4.11	2.54	1.83
Leveling off at 75% Participation	4.42	2.37	1.66
Leveling off at 50% Participation	3.47	1.86	1.12
Employer Burden Reductions (Life Cycle, Constant \$ Billions)			
As Calculated	13.5	6.8	1.6
Less Aggressive Phase In	10.3	6.1	1.4
Leveling off at 75% Participation	10.1	5.1	1.2
Leveling off at 50% Participation	6.6	3.4	.8
Government Reduced/Avoided Costs (Life Cycle, Constant \$ Billions)			
As Calculated	1.7	1.5	.5
Less Aggressive Phase In	1.3	1.4	.4
Leveling off at 75% Participation	1.1	1.0	.3
Leveling off at 50% Participation	.6	.5	.0

* Constant dollars (in billions)

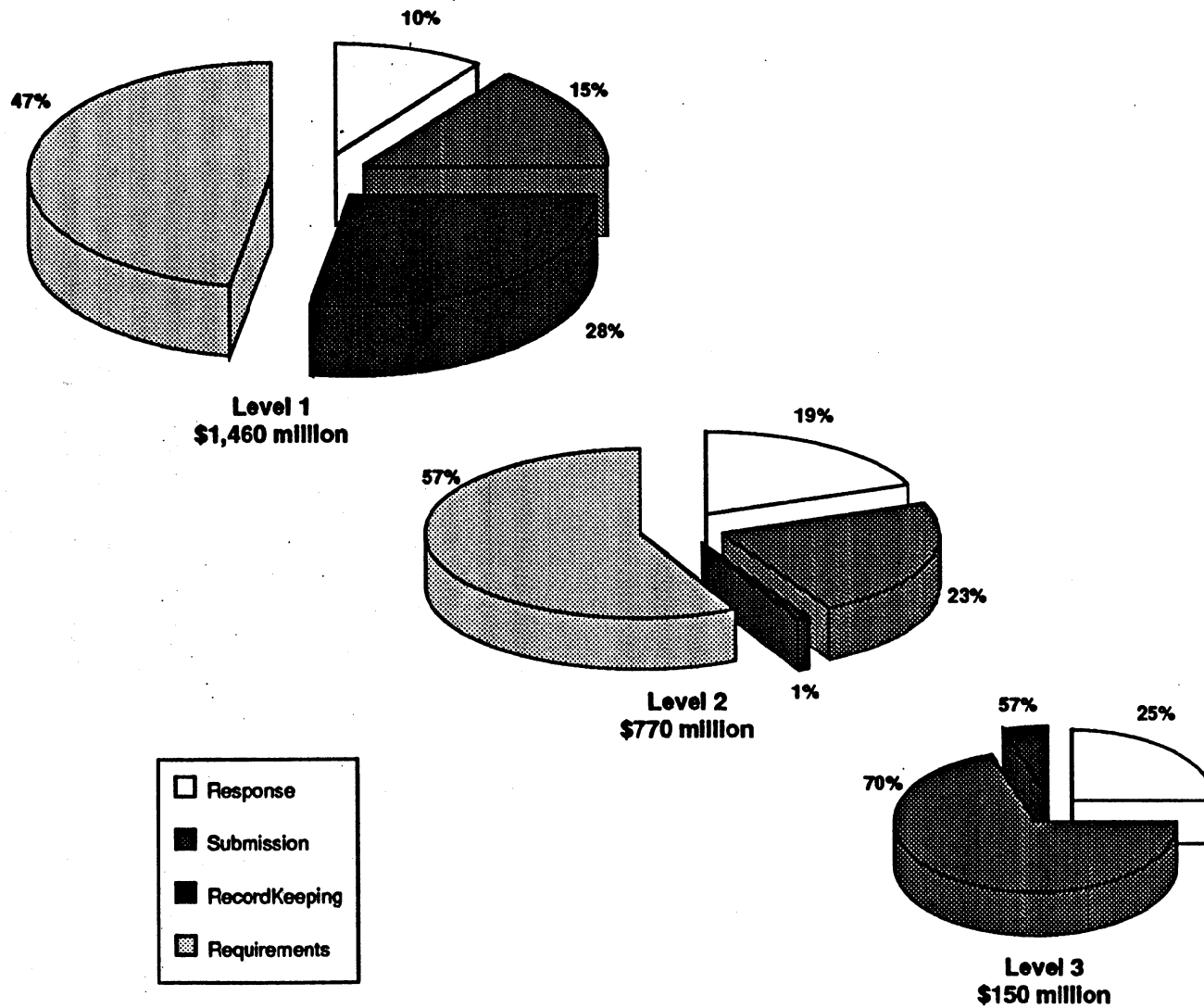


Figure 5-3
2008 Employer Burden Reduction

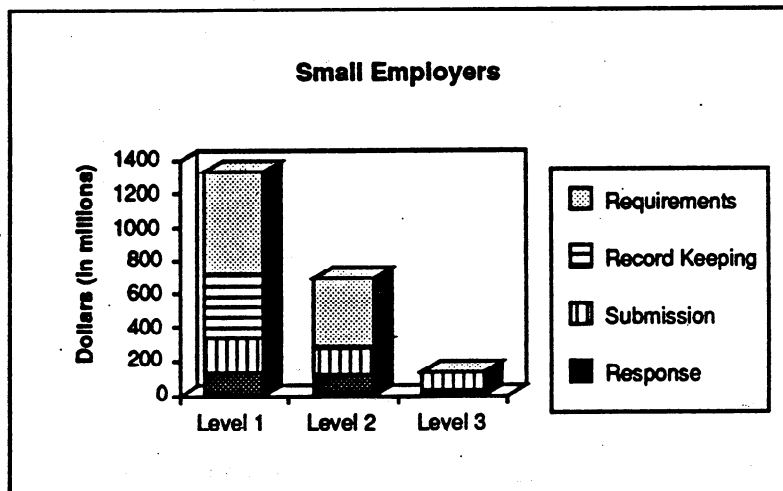
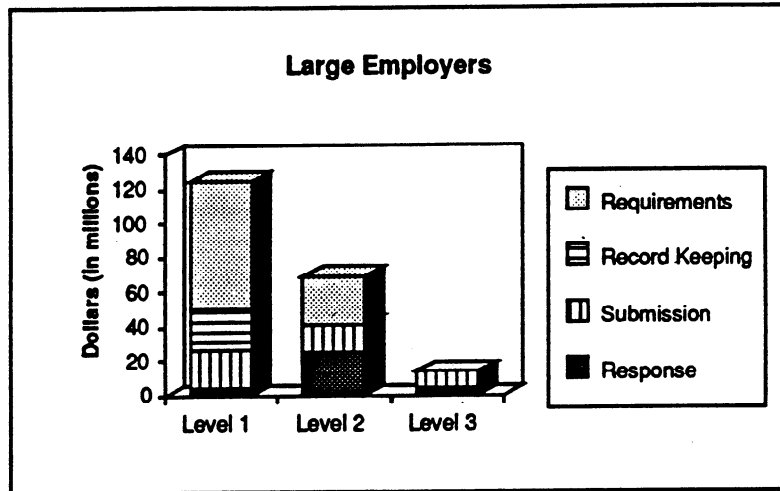
Based on the definitions of large and small employers presented in Section 3, the benefit is substantially greater to small employers than to large employers for all three levels as shown in Figure 5-4. This is due primarily to the larger numbers of small employers (approximately 95 percent of all employers) which have a higher per employee cost of compliance than large employers.

Current Employer Burden

For the employer community, the impact on costs and benefits for all three alternative WRSP levels was measured against a projected baseline estimate of the current employer burden. The employer burden was estimated in this analysis in terms of the total dollars and labor hours expended by employers in meeting the wage reporting requirements of Federal and state agencies. To perform this analysis, two analytical approaches were used to estimate the size and scope of employer wage reporting activities. One approach applies the information available through the OMB under the Federal Paperwork Reduction Act on the burden hours required to complete the Federal forms pertaining to wage reporting requirements. By extending these burden hours by analogy to the state wage reporting forms, a model was developed that provided a quantitative representation of the types of compliance activities and processes in which an employer must engage to report wage data to Federal and state agencies. This model is called the process approach because it focuses on the actual processes that employers typically follow and quantifies the level of effort expended by the employer community based on the total number of employers affected and the total volume of returns submitted.

Consultations with industry representatives revealed that, from their standpoint, wage reporting covers a very broad range of activities. The burden hours specified by OMB under the Paperwork Reduction Act apply only to those activities that directly relate to the compliance process. They include finding requirements, preparing forms, and submitting the forms to the proper Federal agencies. As indicated in Section 3.1, the view from the business community expands this definition to include activities that are triggered by the compliance process, many of which only indirectly relate to completing and submitting the forms.

To develop an estimate of the wage reporting burden from the employer's perspective, a second model, the empirical model, was developed that estimated the burden based on industry experience in meeting Federal and state wage reporting requirements. It also measures the employer burden using actual industry-provided data on labor hours expended and the dollar wage rates that businesses typically associate with the definition of the employer burden. Data on wage reporting burden from several sources were used to develop this empirical model. A collection of large businesses (and several governmental entities) provided a detailed breakdown on their wage reporting activities in terms of both hours and



Note: Scales are different

Figure 5-4
Employer Burden Reduction by Large and Small Employers, 2008

labor rates. The smallest of these businesses has more than 1,000 employees. Several service providers offered publicly available pricing data, as well as private details in support of this study. The latter included some insight into the client mix of payroll service providers and the use of service provider deposit and filing services. A third source of explicit (through sparse) data was made available by accounting and tax practitioners servicing small employers. This group, like the large businesses, also provided data on hours and wage rates. Information from these latter two sources was used to estimate costs for the small employers community.

Based on an aggregate average hourly wage rate of \$20 derived from large and small employer data, the process model yielded a \$6.4 billion estimate of the employer burden. These costs reflect on average the cost of labor and professional services that are applied to the wage reporting process.

Using the same aggregate average hourly wage rate, the empirical model estimated the employer burden to be \$5.9 billion based on the industry definition of the compliance burden.

As previously indicated in Section 3.1, the employer burden used in the process model comprises approximately 70 percent of the employer burden definition that was applied to the empirical model. Even though the empirical model uses this broader definition of the employer burden, it yielded a lower estimate of \$5.9 billion primarily because the empirical estimates include a degree of learning that is not captured in the OMB rates. The OMB burden hour rates appear to be based on manual compliance procedures and do not significantly reflect the economies of scale and cost savings that are realized by businesses through the application of automation technology and the use of service providers. An upper bound on employer burden, which does not include this learning effect, can be estimated by extrapolating the industry definition of the employer burden to the OMB base estimate of \$6.4 billion as provided by the process model. By expanding the OMB definition of the employer burden to include the 30 percent additional burden identified by industry, the employer burden estimate would come to \$9.1 billion. This represents the high end of the employer burden since it is based on the broader burden definition, but excludes much of the learning identified by industry.

Because the \$5.9 billion empirical burden estimate reflects the broader definition of employer compliance activities and reflects industry efficiencies in meeting wage reporting requirements, it is used in this study as a conservative estimate of the total employer burden for complying with Federal and state wage reporting related requirements.

Reduction in Employer Burden

The task of estimating employer burden reduction was carried out by first relating features of WRSP with a breakout of activities that make up the specific employee burden categories

previously described in Section 3, and then estimating how these features would affect the employer's activities. A quantification of that effect was then made.

For some activities, this was straightforward based primarily on the reduction in the number of activities carried out under the current reporting environment and under each alternative. For example; eliminating three quarterly Form 941 filings reduces employer submission preparation burden and associated responses to notices and queries. Similarly, combining of information from an annual Form 941 and the annual W-2/W-3 filing would eliminate the possibility of there being a discrepancy in the dollar amounts currently discovered in government reconciliation activities which occur about 18 months after the W-2 filing. The affect is to eliminate all of the related discrepancy notices. For some WRSP features, a degree of judgment was applied to the estimates of current employer burden for specific employer activities. In the latter case, the finest granularity of employer activity provided by employer representatives was used. For example, more timely government notices would reduce the time required to retrieve and analyze old employer records needed to respond. Each burden reduction potential was differentially applied to the two employer size groups with, in this case, a greater burden reduction being applied to the small employer group which is likely to have the poorer record keeping (record retention) habits. For some features, such as validation of SSN, combined effects were considered (e.g., the added employer burden of carrying out the validation activity, offset by the reduction in the number of bad/missing SSN notices).

In addition to the analysis for each form, payment, and process feature of the three WRSP concepts, an estimation of the value of wage code harmonization in reducing employer burden was made for Level 1. The driving factors identified here were the number and complexity level of the annual changes to current record keeping and filing requirements, the associated time spent in tracking regulatory changes, and the change in complexity faced by the new employer. The relationship between regulatory complexity and errors by both employers and their representatives and the government's systems and staff were also considered. A burden reduction estimate was ascribed to the affects of wage code harmonization based on the reduction in the total number of changes, the reduction in the number of agencies for which changes need to be tracked, and an increase in the consistency among jurisdictions of terms, administrative procedures, and algorithmic representation of rules in software and manual systems.

This analysis of employer burden reduction was carried out separately for each of the three WRSP levels with respect to the small and large employer groups. Percentage change in employer labor hours for each activity were estimated and the hourly wage rates used to compute current employer burden were applied to these labor hour reductions. Not all aspects of WRSP resulted in a reduction in the estimated employer burden.

The approach used to estimate WRSP reductions in employer burden has order of magnitude precision. Table 5-4 illustrates how the results of the overall economic analysis are dependent on employer burden reduction estimates. This sensitivity analysis indicates that the benefit/cost ratio for Levels 1 and 2 is still favorable using low estimates of the employer burden reduction. Even when excluding the employer burden calculation entirely from the analysis, the benefit/cost ratio exceed 1.0. However, given the purpose of WRSP, it should be noted that the exclusion of the employer burden reduction benefit from the calculation is not relevant.

5.2.2 Government Reduced and Avoided Costs

Table 5-5 provides further detail on the life cycle benefits in terms of Federal and state government reduced/avoided costs. Government reduced/avoided costs are estimated by first determining the impact STAWRS would have on reducing costs for all government agencies and then subtracting the cost of operating STAWRS itself. These total government reduced/avoided costs are approximately \$1.7 billion (constant dollars) over the system life cycle for Level 1, \$1.5 billion for Level 2, and \$530 million for Level 3. The primary area of government reduced/avoided costs is in submission processing. Forms currently processed at IRS (e.g., Form 94x) and SSA (e.g., W-2) are now processed at a STAWRS site. A Federal government reduced/avoided cost of approximately \$900 million to \$1 billion (constant dollars) over the system's life would be realized at these agencies depending on the WRSP level implemented. Similarly, state government agencies would realize a reduction/avoidance of state processing costs for both UI and tax withholding processing. The impact on state costs for the system life cycle are \$2.0 billion for Levels 1 and 2. For Level 3, the savings are much less substantial, estimated at over \$230 million over the life cycle.

The total net government reduced/avoided cost benefit is the sum of the Federal and state reduced/avoided costs offset by STAWRS operations costs. The latter includes the processing of new STAWRS forms, training/outreach costs, a large telephone assistance function for Levels 1 and 2, and costs for miscellaneous functions (e.g., employer registration, generation of notices and notice response processing, and similar activities not directly related to the processing of returns and payments). These STAWRS operating costs are approximately \$1.4 billion for Level 1, \$1.6 billion for Level 2, and \$630 million for Level 3.

Cost of Current Government Operations

In generating these estimates of government reduced/avoided costs, extensive analyses were conducted of current Federal and state functional operations and how WRSP may impact these operations. To develop a projected baseline, data were collected from IRS, SSA, six state revenue agencies, and seven state UI agencies. These data pertained to their functional activities (process steps) carried out in accomplishing their wage reporting-related missions.

Table 5-4
Sensitivity in Employer Burden Estimate*

	Cost	Benefit	Benefit/ Cost Ratio
Level 1	1,347	6,790	5.04
Level 2	1,339	3,663	2.73
Level 3	508	1,042	2.05

As Calculated

	Cost	Benefit	Benefit/ Cost Ratio
Level 1	995	3,775	3.79
Level 2	991	2,171	2.19
Level 3	377	649	1.72

With 50 Percent Burden Estimate

	Cost	Benefit	Benefit/ Cost Ratio
Level 1	819	2,686	2.77
Level 2	818	1,425	1.74
Level 3	311	453	1.46

With 25 Percent Burden Estimate

	Cost	Benefit	Benefit/ Cost Ratio
Level 1	643	761	1.18
Level 2	643	679	1.05
Level 3	245	256	1.05

Excluding Burden

*Life cycle percent value dollars (in millions)

Table 5-5
Government Reduced and Avoided Costs, 1994 - 2008*

Reduced/Avoided Costs	Level 1	Level 2	Level 3
Federal	1,040	1,040	930
State Agencies	2,040	2,040	230
Tax Withholding	490	490	230
UI	1,300	1,300	0
ES 202	250	250	0
STAWRS Operations Costs**	(1,430)	(1,560)	(630)
	1,650	1,520	530

* Constant dollars (in millions)

** Direct labor, plus, management supervision and training, plus resource costs.
Does not include functions that would remain at government agencies.

Because most of the UI costs are accounted for at the state UI level, the baseline costs analysis for DOL was carried out at an aggregate level. Generally, all of the Federal and state functional activities described in Section 3 of this document, except for Social Security claims processing, state tax compliance processing, and UI claims and compliance processing, were included in this analysis. Table 5-6 identifies the major IRS and SSA workload drivers and functional areas included in this analysis. The data collected and analyzed for each Federal and state process step included current workloads, labor categories, and labor productivity. Financial factors (e.g., labor pay rates, overhead rates, management burden, training, benefits, etc.) were also collected for each agency. Future workload was projected for the economic life of STAWRS based on projected growth in the employer/employee population and forecasts of future annual returns volumes provided by IRS and SSA.

Analytical models were developed to project process step workloads and functional labor utilization throughout the WRSP life cycle for IRS and SSA activities. A single state UI agency model and a single state revenue agency model were developed based on the data collected from the states visited. Due to the diversity of state agency activities these latter models were at a somewhat more aggregate level, having fewer and more combined process steps than the IRS and SSA models. These models were used with projected nationwide state revenue and UI workloads and to estimate future aggregate costs for these state level agencies. Projected future baseline costs for DOL's ES-202 labor statistics and ETA programs were based on extrapolation of current Federal budgets for these agencies.

Impacts on Current Government Operations

To determine the STAWRS impacts on current Federal and state government operating costs, the process steps and/or functional operations in the baseline were examined to assess how each of the WRSP levels may impact them. This analysis was carried out for the complete functionality of Levels 1, 2, and 3 described in Section 4 of this document. In a WRSP environment, specific forms would be eliminated or replaced by a new combined STAWRS form. In such cases, costs for processing these forms are eliminated or greatly reduced.

For IRS, for example, all wage-related tax forms and payments would be processed by STAWRS through the unpostable resolution processing step in Levels 1 and 2, whereas in Level 3, only tax forms would be processed by STAWRS, and unpostables would be resolved by each participating agency. In addition, under all three alternative WRSP concepts, certain compliance programs such as CAWR would be eliminated since Form 941 would be annualized and combined with the W-3. Federal Unemployment Tax (FUTA) certification would be transferred to STAWRS, as would wage-related taxpayer assistance in Levels 1 and 2. For SSA, for example, processing of W-2/W-3 submissions would be transferred to STAWRS for Levels 1, 2, and 3; and employer telephone assistance would be transferred under Levels 1 and 2.

Table 5-6
Major Baseline IRS and SSA Workload Drivers and Mission Functions

Workload Drivers	Functions
<p>IRS</p> <ul style="list-style-type: none"> • Form 940/940PR • Form 940EZ • Form 941 • Form 942 • Form 943 • Federal Tax Deposit Coupons • Taxpayer Assistance Phone Calls* • Correspondence and Notices* 	<p>IRS</p> <ul style="list-style-type: none"> • Combined Annual Wage Reporting (CAWR) Processing • Federal Unemployment Tax (FUTA) Reconciliation* • Non-filer and Return Delinquency • Adjustments and Correspondence* • Entity Control* • Taxpayer Assistance*
<p>SSA</p> <ul style="list-style-type: none"> • Annual Income and Tax Statements, W-2 • Transmittal of Income and Tax Statements, W-3 • Self-employment data (received through IRS) 	<p>SSA</p> <ul style="list-style-type: none"> • Annual Reporting Review • Annual Reporting Data Entry • Annual Reporting Balancing • Annual Reporting Correction/Adjustment • Annual Reporting Reconciliation

* These functions include activities which encompass more than wage-related forms and data. The total costs for these functions were prorated to obtain an estimate of those costs attributable to wage-related activities.

Examples of STAWRS impact on the current state revenue agencies include all tax returns and payments, and state W-2 equivalents and processing under Levels 1 and 2, but only state W-2 equivalents processing under Level 3. Similarly, for state UI agencies, all contribution reports, payments, and quarterly wage would be carried out by STAWRS in Levels 1 and 2, resulting in reduced operating costs for these WRSP participants.

Prudent implementation of a new system like STAWRS may require parallel operations of current systems and new capabilities during startup. For this reason, a percentage of the baseline costs was subtracted from the estimated reduced/avoided cost estimates in early years of implementation to account for such parallel operations.

Cost of Operating STAWRS

As previously described, the costs of operating STAWRS under Level 1 is approximately \$1.4 billion (constant dollars) over the STAWRS life cycle, approximately \$1.6 billion for Level 2, and approximately \$630 million for Level 3. A breakout of these costs by participating agency, or class of agencies, is not possible at this time, as a cost allocation formula has not been developed. Issues regarding cost allocation are further discussed in Section 6 of this document.

To estimate the costs of operating STAWRS, workload drivers were identified, and process models were developed for the major steps needed to provide the features defined in each STAWRS alternative. Workload driver estimates were broken out to differentiate between paper, magnetic, electronic, and voice inputs. The modern technology environment described in Section 4 was used in estimating categories of staff needs, productivity rates, services (e.g., voice and data telecommunications) and expendables, and workloads on system components (the latter used to estimate the quantities of equipment needed -- see Section 5.3). Labor hour estimates are dependent on the characteristics of each driver (e.g., the average expected number of pages in a paper submission, the expected number of data fields, the characters per field, percent of forms type written, and expected OCR success rate).

In addition to operating cost estimates for the process steps required in submission and payment processing, estimates were formulated for STAWRS telephone assistance (based on expected telephone call volume and average time per call using automatic call directors), submission package preparation and mailing, outgoing correspondence and notice generation and incoming notice and correspondence processing, and training/outreach functions. Table 5-7 presents estimates of annual functional operations staffing requirements for each STAWRS alternative at full implementation.

To account for inefficiencies in start-up and early operations of STAWRS, a learning curve was applied to inflate STAWRS operating cost in the early years of operations.

Table 5-7
STAWRS Staffing Profile
(FTEs In 2008, At Full Implementation)

Function	Level 1	Level 2	Level 3
Submission Processing	1,400	1,401	977
Telephone Assistance	1,882	1,882	665
Remittance Processing	58	58	0
Correspondence (Incoming/Outgoing)	115	115	79
Training/Outreach	276	276	0
Subtotal (Does not include SAT/POS/Site FTEs)	3,731	3,732	1,721
System Control (Includes SAT/PDS Site FTEs)	167	167	91
Software Maintenance	58	73	14
TOTAL	3,956	3,972	1,826

5.3 COSTS ASSOCIATED WITH THE ALTERNATIVE WRSP CONCEPTS

The overall costs to implement each WRSP level (shown earlier in Table 5-1), range from \$800 million to \$2.2 billion. This includes the costs of hardware and software acquisition and O&M, government agency transition, and employer transition. Costs for STAWRS acquisition and life cycle system O&M range from \$430 million for Level 3, to \$1.1 billion for Levels 1 and 2. Equally significant is the cost to the employer community to change from current wage reporting practices to the STAWRS environment. This cost could reach \$1.1 billion during the transition period for Levels 1 and 2, and \$360 million for Level 3. Government transition costs are the costs to the government to convert present systems to accept STAWRS data and formats, and are estimated to be \$50 million for Levels 1 and 2, and \$20 million for Level 3.

Table 5-8 provides further detail on the life cycle cost estimate. The total hardware acquisition is estimated at \$175 million for Levels 1 and 2, and \$55 million for Level 3. To develop these hardware cost estimates, hardware capacity requirements were estimated based on workload drivers and the information/telecommunications system workload estimates mentioned earlier as outputs of the STAWRS process models for Levels 1, 2, and 3. These capacity requirements were translated into units of required equipment using the characteristics of today's technology. Hardware throughput and cost factors were based on data from multiple vendors or examination of similar systems. General Service Administration equipment pricing for 1992 was used where available; otherwise mid-range vendor prices were assumed. Hardware capacity was phased-in for each alternative according to the previously described implementation schedule. Only the initial hardware buy has been included in the hardware cost estimates, as hardware replacement is not expected to be needed prior to the end of the life cycle used for this economic analysis.

The software development effort is estimated at \$160 million for Levels 1 and 2, and \$40 million for Level 3. Required software development areas were identified in Table 5-9 based on the definitions of STAWRS functionality. The level of effort, duration of development, and development costs for each of these software development areas were based on analogy to systems with similar functionality and processing requirements. These costs were distributed on a gross basis over the development period. It was assumed that the entire software development effort will be carried out under contract. Thus, prevailing commercial software development rates were used in estimating development costs.

Other supporting acquisition-related costs were estimated using the cost estimating relationships derived from historical, industrial, and government data. These costs included program management/systems engineering/project management, hardware installation, commercial-off-the-shelf software, systems integration and testing, site preparation, initial training, and initial spares.

Table 5-8
Life Cycle Costs, 1992 - 2008*

Cost Category	Level 1	Level 2	Level 3
STAWRS	1,100	1,100	430
Acquisition/Operations and Maintenance			
Acquisition	430	430	120
Hardware Equipment and Installation	175	175	55
Software Development	160	160	40
Supporting	95	95	25
Operations and Maintenance	665	665	310
Government Transition	50	50	20
Software Conversion (Federal)	30	30	10
Forms	20	20	10
Redesign/Harmonization			
Employer Transition	1,080	1,080	360
GRAND TOTAL LIFE CYCLE COSTS	2,230	2,230	810

* Constant dollars (in millions); columns may not equal total due to rounding

Table 5-9
STAWRS Software Development Areas

Submission Processing Facility <ul style="list-style-type: none"> • Incoming Submission Processing • Archiving System • Payment Processing • Electronic Processing 	Data Management Facility <ul style="list-style-type: none"> • Master Data System • Reporting • Accounting • Workload Management • Submission Package Generation • Communications • Security
User Service Facility <ul style="list-style-type: none"> • Employer Registration • TIN Validation • Employer Advice, Service, and Education 	Support Facility <ul style="list-style-type: none"> • Master Reference • Software Development Tools

STAWRS O&M costs include contract hardware maintenance, hardware operating personnel (e.g., computer operators, tape librarians), software maintenance personnel, personnel-related costs (e.g., management and supervision, training, benefits, and overhead), telecommunication services, hardware maintenance contracts, software licenses, software supplies, and O&M-related facilities. These costs would be incurred following hardware procurements and the completion of software development modules. Their full impact is not felt until the system is fully developed and operable (1999 to 2000). At that time, annual expenditures approximate \$20 to \$55 million per year depending on the alternative WRSP level implemented.

Government transition costs, estimated to be \$20 million to \$50 million, include the software conversion costs for Federal (IRS, SSA) government to change over to STAWRS data definitions, formats, timing, and other specifications. These costs also cover forms redesign and wage code harmonization cost. The forms redesign and wage code harmonization staff will handle the initial development and testing of new STAWRS forms. The staff will also harmonize Federal, state, and employer requirements. It is expected that this staff will be larger during initial development and then continue at a lower level through the life cycle. No conversion costs are estimated for DOL.

Separate state transition costs have not been estimated. State transition costs will vary depending primarily on how a state chooses to interface with STAWRS, and the detailed design of current state wage data query and analysis software. For those states wishing to acquire copies of STAWRS data for use in existing state systems, transition costs may well be zero. STAWRS could provide these data in a limited number of standard tape formats similar to those used currently by employers sending magnetic or electronic returns directly to the states. For states wishing to access authorized STAWRS data via online query, modifications to local state software may be required. The extent of such modifications (and associated costs) requires an understanding of specific state software and systems capability and design beyond that currently available for this feasibility study.

Finally, employer transition costs are estimated to be as significant as the overall cost for development and acquisition of the system. All employers will have to go through some additional learning process akin to finding, understanding, and implementing the provisions of wage reporting laws and regulations. Some will have to change existing in-house automated systems, and others will have to acquire new releases of commercial software packages. The large number of employers is likely to make the associated costs of transition significantly larger than the government transition costs. For the purpose of this feasibility study, these employer costs for Levels 1 and 2 were estimated to be equal to one year of employer costs for finding, understanding, and implementing the provisions of the law, after adjusting for the costs incurred by new business start-ups and dealing with the standard annual changes in withholding tables and new forms. Under the limited scope of Level 3, the transition costs are primarily related to annualization of Federal Forms 941 and 942, and are conservatively

estimated as equal to one year employer benefit. For Levels 1, 2, and 3, these costs are assumed to start midway through STAWRS development and continue as state participation increases.

5.4 OVERALL IMPACTS ON STAKEHOLDERS

5.4.1 WRSP Impact on the Employer

Figure 5-5 depicts the impact of employer burden reduction and transition costs for Levels 1, 2, and 3 against a projected baseline trend for the current employer burden. In this figure, the annual baseline employer burden of \$5.9 billion estimated for 1991 is extrapolated based on the annual growth in workload drivers or the number of forms that IRS, SSA and state agencies are expected to process over the course of the STAWRS life cycle. For each alternative, the estimated transition costs were added in each year -- based on their respective implementation schedules -- to the baseline estimate as an additional burden that is imposed on employers while they change their operations to meet the new STAWRS wage reporting requirements. Conversely, the projected benefits of Levels 1, 2, and 3 were subtracted from the baseline estimate as an indication of the reduction in burden that employers are likely to experience under STAWRS operations.

Figure 5-5 indicates that under Levels 1 and 3 employers are likely to experience a net reduction in burden from STAWRS operations within about one year of implementation. Under Level 2, the larger initial transition costs and smaller burden reduction extend this period to about two years. The cumulative impacts are significant for Levels 1 and 2, but marginal for Level 3.

5.4.2 WRSP Impact on Government Agencies

Table 5-10 provides a single year view of the impact of STAWRS on the government agencies by displaying the estimated government costs for each of the Federal agencies and an aggregate estimate for the state agencies in the year 2008. The baseline estimate is the projected cost of current operations for wage reporting and related functions in the year 2008 and assumes no change in current functionality and operating procedures. It is estimated based on return growth and employer growth projections. For each alternative, functions not included in STAWRS are left to the agencies current carrying out these functions. STAWRS operations costs include the cost to process new STAWRS forms, expanded telephone assistance, training and outreach programs, and other related costs. The total government cost in the year 2008 would reach \$268 million for Level 1, \$284 million for Level 2, and \$389 million for Level 3. This results in a net savings of \$116 and \$100 million for Levels 1

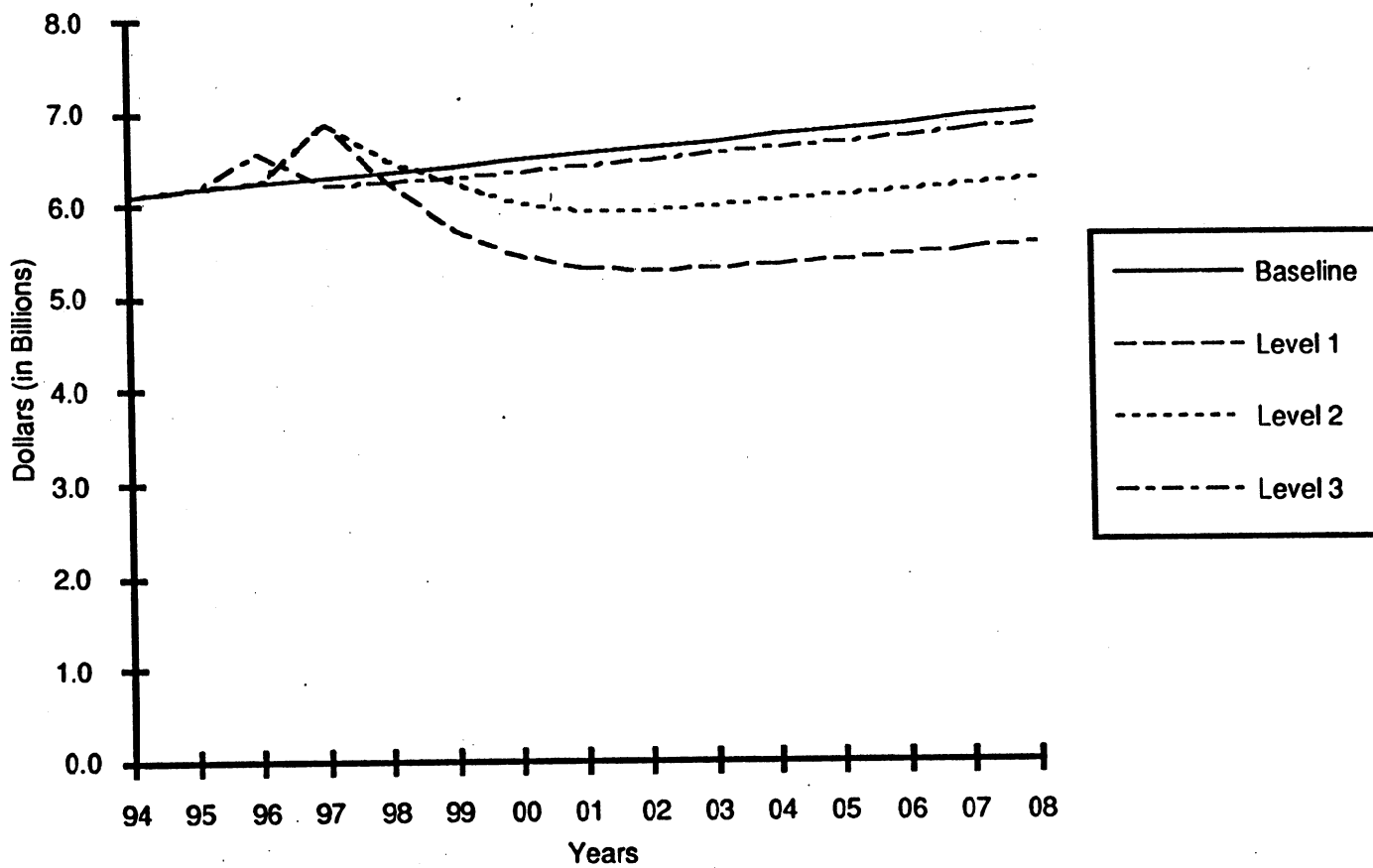


Figure 5-5
Employee Burden Estimates

Table 5-10
Annual Government Net Costs at Full STAWRS Operation, 2008*

Cost Category	Baseline	Level 1	Level 2	Level 3
Federal Government	175	107	107	133
IRS	138	107**	107**	133***
SSA	37	0	0	0
State Agencies	209	0	0	189
Tax	51	0	0	31
UI	134	0	0	134
ES 202	24	0	0	24
STAWRS Operation Cost	--	161	177	67
Submission Processing	--	32	32	23
Telephone Assistance	--	62	76	22
Training/Outreach	--	11	13	--
Other Functions	--	30	30	4
Other Resource Cost	--	26	26	18
TOTAL GOVERNMENT COST	384	268	284	389
GOVERNMENT BENEFIT REDUCED/ AVOIDED COSTS	--	116	100	(5)

* Constant dollars (in millions)

** Includes non-pipeline, CAWR, FUTA certification, adjustments and correspondence, entity control, and non-filer/delinquent returns processing activities related to wage reporting and not provided by STAWRS functionality, plus current telephone assistance, correspondence, and registration processing

*** Includes the above plus FTD processing and processing of quarterly Employer's Tax Returns (Forms 941 and 942)

and 2, and a virtual break-even situation for Level 3. As previously mentioned, it is not possible to compute a net cost to each agency without a STAWRS cost allocation formula. This is one of the institutional, legal and regulatory issues addressed in Section 6.

SECTION 6

POTENTIAL INSTITUTIONAL, LEGAL, AND REGULATORY ISSUES IMPACTING WAGE REPORTING SIMPLIFICATION PROJECT IMPLEMENTATION

6.1 OVERVIEW OF ANALYSIS

In assessing the feasibility of WRSP, a number of issues must be addressed which lie outside the scope of employer burden reduction, user agency requirements, the operational concepts, and costs and benefits. These issues pertain to the institutional, legal, and regulatory concerns that may either advance or delay implementation of specific WRSP scope and functionality features, and the ability or propensity of agencies to participate in WRSP. Through the numerous meetings held with the representative WRSP stakeholders (see Section 2) and a review of related reports and publications, a preliminary list of such issues has been formulated. The issues identified, to date, fall in four major categories:

- Organizational and institutional
- User interface
- Privacy and disclosure, and security policy
- Wage code harmonization

Key aspects of these issues are discussed in the following sections. Several general, and perhaps overriding issues, however, warrant discussion at this point.

Need for Cooperation

Based on the discussions held thus far with government agency and employer representatives, it becomes clear that many see the significant potential and positive benefits that can be achieved through the successful implementation of WRSP. In today's economic climate, business and government are seeking ways to become more effective and efficient, and to reduce costs while raising revenues and/or profits. Thus, there is a propensity on the part of all parties (as exhibited by the active participation of the employer community and state agencies, and the actions of the IRS/SSA Executive Policy Council) to actively participate in formulation of this program.

The continuation of this level of participation by all stakeholders is critical to the eventual success of what must be a cooperative venture. Any issues that arise among stakeholders must be openly addressed early in the program, and a cooperative means must be found to overcome their potential for impeding or inhibiting successful WRSP implementation.

A key factor in attaining this cooperation is to assure clear and open communication, by sharing of plans and findings among all participating stakeholders. The numerous briefings, and sharing of preliminary results of this feasibility study, have been attempts to achieve this objective. Viewing WRSP as a cooperative venture between Federal and state governments and agencies is another factor that will significantly contribute to potential program success. By addressing those issues, WRSP has a significant chance to achieve the benefits identified earlier in this document.

Management and Operation of WRSP

As indicated in the introduction to this document, initiation of this wage reporting simplification effort was stimulated by entities outside the Federal Government. Dialogue with state entities over the past few months has indicated a perception on their part that WRSP is a Federal program which is likely to be managed by the Federal Government for its and the states' benefit. Such a management structure is, however, only one possibility. Figure 6-1 illustrates several possible structures for WRSP, ranging from Federal management and operation, through management by a Board of Governors representing all participating agencies and operated either under contract or as a semi-autonomous public corporation (somewhat like the U.S. Postal Service). Two factors will ultimately determine the most appropriate management and operating structure for WRSP: the program's scope and functionality, and the control required by the participating agencies.

If WRSP is narrow in scope and function, similar to Level 3 described in Section 4, the program may be managed by the Federal Government and operated either by a Federal agency or under a contract to provide primarily data processing services. However, if WRSP has broader scope and functionality, agencies may require more active participation in decision making and control to assure WRSP priorities, production schedules, and a balance of costs and operations to meet the needs of all parties. Early determination of management, control needs, and operational desires of potential participants is important in establishing an acceptable and appropriate structure for WRSP.

Approach to Implementation of Legal and Regulatory Change

With respect to the legal and regulatory issues impacting WRSP implementation, a major factor will be achieving a consistent set of laws and regulations under which WRSP will operate. With respect to one aspect of law and regulation discussed earlier in this document (wage code harmonization), a parallel is drawn with the Uniform Commercial Code. This set of laws, which was established to simplify, clarify, and modernize the law governing commercial transactions, brings together in one place the guidance needed for commerce to operate across all 50 states. Current Federal and state laws governing wage and wage tax administration not only vary from jurisdiction to jurisdiction, but are also scattered throughout the codes of the Federal and state governments. For example, laws at the Federal level, which govern privacy and use of data that could impact WRSP, appear in the Internal

Revenue Code (26 United States Code (USC)), the Social Security Act (42 USC), the Privacy Act (5 USC), the Computer Security Act, The Freedom of Information Act, the Electronic Communications Privacy Act (18 USC), and Records Management by Federal Agencies (44 USC), among others. Similar fragments of codes at all levels of government will impact this and other aspects of WRSP, making it difficult for the Federal and state governments and agencies to easily understand the potential impacts that these laws and regulations may have on WRSP and its operations.

In this regard, it has been suggested that a new code, implemented as omnibus legislation, be developed as an integral part of WRSP development. This new code would cover in one place all matters of specific concern to wage reporting simplification. It would thus provide all participating agencies and governments a clear understanding of the ramifications of WRSP participation. It is clear that development of such a code will not be a trivial undertaking. Parts of WRSP functionality may be implemented prior to full completion and adoption of such legislation. However, to maximize the benefit of WRSP and to promote maximum participation, cooperative Federal and state effort toward such an end is warranted.

Toward this end, it is recommended that an effort be undertaken as soon as possible to formulate a strategic plan for addressing these and other institutional, legal, and regulatory issues addressed in this section. Formulation of such a plan should be a concerted short-term effort involving representation of all WRSP stakeholders. As a related near-term effort, it is also recommended that an effort be initiated at the Federal level to better align Federal laws and regulations as a model for broader effort.

6.2 ORGANIZATIONAL AND INSTITUTIONAL ISSUES

In addition to management and operation of WRSP discussed in the introduction to this section, organizational and institution issues deal with:

- Compliance-related activities
- Use of non-government organization to deliver STAWRS services
- Cost sharing
- One-stop service and training

*** *Compliance-Related Activities***

As discussed in Section 4 of this document, it is envisioned that STAWRS may provide information support to claims and compliance activities, but that the participating agencies would carry out all related compliance activities. At least two aspects of compliance, however, warrant discussion; the first relates to delinquent returns, and the second relates to collection of delinquent taxes.

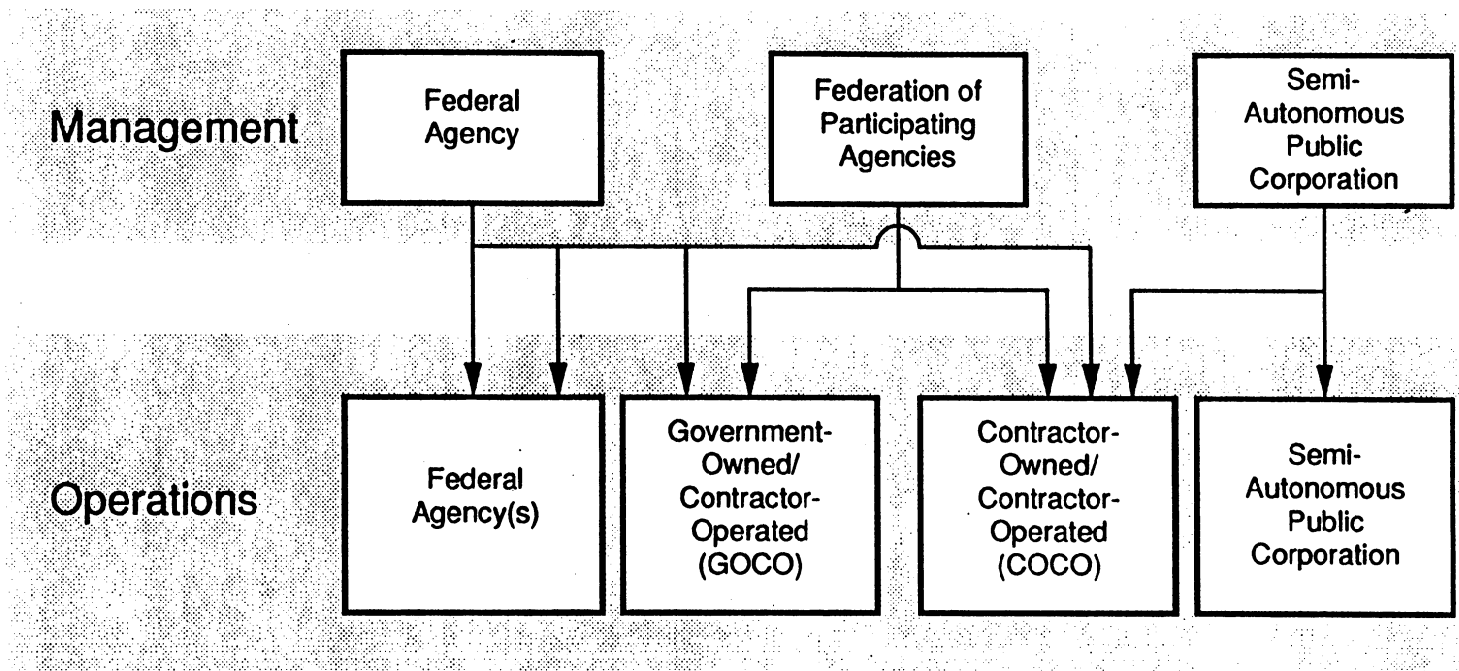


Figure 6-1
Example Options for WRS Management and Operations

Under the various WRSP concepts, returns would no longer be clearly Federal (IRS or SSA) or specific state returns, because they would contain data for all participating entities. Thus, responsibility for collection of delinquent returns is either every participant's responsibility, implying many potential contacts with an employer, or a coordinated responsibility that could be managed with the assistance of WRSP data. In either case, the requirements and procedures for obtaining delinquent returns under WRSP present a new issue which must be addressed.

The second issue, collection of delinquent taxes, has at least three aspects: allocation of short and long payments accompanying a payment coupon, pursuing late payments, and making available to agencies the information needed for making assessments and obtaining liens and levies. With respect to the first issue, it is envisioned that an equitable formula for application of short and long payments would be a part of the WRSP operating rules agreed upon by the participating agencies. With respect to the second issue, although it is envisioned that each agency may independently pursue late payments, cooperative Federal/state(s) efforts may be possible outside the scope of WRSP, which, in addition, may increase the effectiveness and reduce the costs of collection activities. With respect to liens and levies, concern has been raised regarding the timing of available information, as the order of establishment often determines the order of access to assets. In this regard, either a mechanism would have to be worked out for simultaneous notification of all participating agencies, or, if possible, a cooperative approach would be needed for joint application and service which equitably shares the recovered taxes among the participating parties.

Although carrying out compliance efforts is not a WRSP function, efforts to establish WRSP, and cooperation in its operation, may provide a forum for participating agencies to address efficiencies in other compliance-related issues, such as coordinated wage tax-related audits, claims fraud, and similar issues.

Use of Non-Government Services

Within an appropriate management structure, STAWRS may be operated in a variety of ways, including within the current operations of one or more Federal agencies (e.g., IRS and/or SSA), as a government-owned/contractor-operated (GOCO) entity, as a contractor-owned/contractor-operated entity (COCO) through standard commercial contract services, and others. The selection of an appropriate operating entity is dependent primarily on the functions STAWRS will carry out and on the applicable restrictions under the laws of the participating agencies. Current Federal regulations, as spelled out in OMB Circular A-76, Performance of Commercial Activities, place some restrictions on services that may be performed by the private sector. Among these are government functions requiring the exercise of discretion in applying government authority, the act of governing, the collection of taxes and revenue disbursement, and control of revenue accounts. It is likely that similar guidelines exist for state governments. Within these guidelines, IRS today uses the Federal banks through the FTD system to process employment tax and other tax payments, and

lockbox operations to process some other payments. IRS is considering expanding its future use of lockbox activities. Along similar lines, many of the state revenue and employment security agencies currently use lockboxes to provide mail handling services, process tax payments, and, in some cases, data entry of returns information.

Although WRSP is not directly involved in conducting compliance activities, precedent does exist for some level of compliance function support being carried out by non-government staff. The Multistate Tax Commission, for example, carries out audits of businesses across state lines for single states or groups of states which have interests in a single business entity. At least one state uses a service company to carry out collection activities up to the point of assessing penalties and placing liens on assets.

The decision as to whether or not to use a non-government entity to operate all or part of WRSP will depend, therefore, on its scope and functions, desired/required control over the operating entity, applicable regulatory limitation, and costs of operation.

Cost Sharing

WRSP is expected to provide direct benefits through processing cost reduction to all of the participating government agencies. As such, it can be expected that the costs of WRSP will be borne by those agencies. (Although a comment made by one employer representative participating in a WRSP review meeting indicated a willingness to pay a small filing fee if it could be assured that submissions would be processed timely and without error, such a fee for indirect benefit may not be feasible.)

The costs of WRSP may be shared in several ways depending to some extent on how it is managed and operated. If WRSP is managed and operated by Federal or non-government entities, full cost recovery is one possibility, by which all costs are shared among participating agencies according to an appropriate allocation formula. If WRSP is operated by a Federal entity, marginal cost sharing may be used, by which only the incremental costs of capturing and processing data not directly used by the Federal Government. Although having the Federal Government paying all costs with no cost to the states is an option, it is unlikely to be implemented for any but the most limited version of WRSP scope and functionality.

Today, some of the costs realized by state governments for processing payments and returns are paid for through the use of compensatory balances from lockbox operations. Consideration of similar approaches may be a feasible way of offsetting some of WRSP's operating costs.

In addition to the primary WRSP participating agencies, others, such as state welfare and entitlement agencies, Bureau of Census, Economic Development Administration, Immigration and Naturalization Service, and U.S. Department of Agriculture, currently rely on

on data collected through revenue and unemployment programs for statistical information and various authorized program administration, compliance, and enforcement activities. Cost sharing approaches, such as a fee for service basis, for these potential authorized users also need to be considered.

Initial development and investment costs will be realized depending upon the WRSP management and operating structure, assuming that resources to operate WRSP are not totally available within an existing agency such as IRS or SSA, and assuming that current modernization programs being implemented by these agencies will not have all of the capacity needed for WRSP. How WRSP is initially financed is another cost sharing issue that will need to be addressed. Capitalization, if needed, may be financed through some combination of Federal and state funding, or with all Federal funding. Alternatively, if WRSP is to be operated by a non-governmental entity, it may be possible to utilize existing capacity of commercial processing centers, or to arrange for commercial financing as part of a services contract. The latter approach has been successfully used in the past by state and local governments in programs requiring large capitalization, such as resource recovery.

One-Stop Service and Training

Several of the WRSP concepts addressed in Section 4 of this document included one-stop service for employers or their representatives to obtain both technical and account-related information and training within the realm of WRSP scope and functionality. It is envisioned that STAWRS and its operating staff will have the capability to address employer technical needs regarding STAWRS submissions, a harmonized wage code, and account information -- the latter to the extent that STAWRS maintains account-related data. This service is one of the major contributors to employer burden reduction. Response to employer queries beyond this scope may have to be referred to participating agencies. Such queries may relate to technical issues regarding particular entitlements, state regulations regarding independent contractors not included in a harmonized wage code, or account offset actions against refunds or balances taken by a state or Federal agency. In such cases, in order to provide one-stop service, it will be necessary for participating agencies, both Federal and state, to maintain an available employer service capability to which WRSP staff can forward calls. Although such agency service may not be uniformly responsive to employers' needs, the greater the online responsiveness, the more likely it will be to realize the employer burden reductions estimated in the preliminary benefit/cost analysis.

6.3 USER INTERFACE ISSUES

User interface issues relate to those cases where an employer, an employer representative, or a participating government agency interacts electronically with the STAWRS. Recent technological advances in the areas of electronic data transmission and electronic funds transfer are transforming the way business is done. Many of the

labor-intensive and often repetitive tasks associated with handling paper may be eliminated by automated processes. Several such electronic interaction approaches are discussed in Section 4, some of which are currently in use to a greater or lesser degree, including electronic filing, online data entry using microcomputers and touchtone telephones, and electronic funds transfer. Technology for controlling and monitoring such interactions is either available or in a rapid state of development. In many cases, current regulations have not yet caught up or kept pace with these developments. A few areas warranting particular attention include authentication, standards for electronic funds transfer, and media for retention and archiving of original submissions from employers. Much of the existing law was written to address the use of paper as the medium for data transfer and recording. Extensions are required in some cases to encompass the capabilities of electronic media.

Authentication

Historically, authentication of a document has been accomplished with manual signing and placement of unique seals. The practice extends to today with acknowledgement of a notary public's signature and embossed seal. Though IRS' and several states' current electronic filing programs have done much to speed processing of individual tax returns, the filer is still required to submit a signed jurat as certification of the correctness of his/her submission. As a result, a significant amount of residual paper still needs to be processed. Because it is envisioned that STAWRS will emphasize electronic filing as a preferred medium for submission, the authentication of such submissions is an important issue of concern. There is also significant concern regarding release of tax and other information via terminal and telephone without proper authentication of the requester. Not only is it essential to establish that a transmission is from a positively identified sender, but it is also essential to provide non-repudiation -- that is, an uncontestable authentication of submitter and an uncontestable acknowledgement of the fact of receipt and validation of content.

Many commercial concerns, such as banks and credit card companies, successfully use Personal Identification Numbers as a means of authentication. The National Institute of Standards and Technology (NIST) is currently working to establish an electronic signature standard. Current technology includes public and private keys to authenticate encrypted electronic transmission and provide non-repudiation. The applicability of such solutions to STAWRS needs must be reviewed, and regulations may need to be modified as needed to provide an alternative to physical signatures as a means of authentication.

Standards for Electronic and Magnetic Filing

Regulations have been in place for some time requiring the filing of Form W-2 electronically for employers with 250 or more employees. In most states, revenue agencies have mirrored these requirements, as have many employment security agencies. Efforts are underway to expand the use of Electronic Data Interchange (EDI) for the filing of wage and

tax data. The Interstate Conference of Employment Security Agencies (ICESA), for example, has been working on unifying EDI standards for submission of unemployment wage data. Extension of the use of electronic filing in STAWRS may require changes to regulations for some participating agencies.

Incentives for Electronic Filing

Capture of data in electronic form at the point of origination is usually the most cost effective, most timely, and most accurate method of data acquisition. Thus, STAWRS is expected to emphasize electronic filing to the extent practical. This is not to say that every small employer will be required to automate its operation and electronically file returns. Over the past few years, IRS and state revenue authorities have had significant success in implementing electronic filing programs through tax preparers and service bureaus. The key incentive for using electronic filing has been providing the taxpayer with quicker access to his/her tax refund either through more rapid processing of electronically filed returns or through privately arranged refund anticipation loans.

If WRSP is to be successful in stimulating electronic filing, similar incentive programs or regulations requiring electronic filing at least for some portion of the employer population may be needed.

Payment Via Credit Card and Electronic Means

Most tax systems today require payment via a means other than credit, usually using paper checks, electronic funds transfer, or an automated clearing house. The IRS FTD system, for example, requires an employer to make a bank deposit which is subsequently transmitted using the FedWire system to a Treasury account. Several states similarly use an automated funds transfer capability, especially for their larger taxpayers. Changes to existing regulations may be required by some jurisdictions to broaden the utilization of such payment approaches, and to permit payment via credit. IRS has requested legislation to permit credit card payment, the details of which have been worked out. Standards for AOC information may also be needed for electronic funds transfer to be able to indicate desired funds allocation for a single payment made to STAWRS.

6.4 PRIVACY, DISCLOSURE, AND SECURITY POLICY

The data to be processed by and potentially stored in STAWRS are primarily entity identification, employment, and wage and tax-related information, which are considered sensitive by individuals, business, and government. The rights of individuals and business to the protection of these data have been the subject of considerable interest by a broad range of WRSP stakeholders, including lawmakers, government administrators, civil liberties organizations, and the citizenry. Such rights must be maintained. Privacy and disclosure of

data about either employees or employers are carefully protected by Congress and state governments under existing laws. In particular, information regarding wages and taxes is precisely defined and its dissemination controlled. STAWRS must be designed, developed, and operated so as to protect these rights.

It is important to note that:

- No new data will be collected beyond that already collected today
- A comprehensive security policy and program will control access to STAWRS data
- Electronic access to data will be limited to authorized users as is the case today
- Current data sharing agreements will continue in force unless specifically modified as part of new legislation, regulations, or inter-agency agreements

Section 4 of this document described several concepts for STAWRS in terms of functionality and logical system architecture. Implementation of these concepts may take various physical forms ranging from highly centralized to broadly distributed. In today's environment, data and functions related to wage reporting are broadly distributed with limited direct interface of information systems. Data center consolidation implied in some potential physical implementations of these STAWRS concepts is likely to raise questions about privacy and disclosure.

Today, industry and government organizations are seeking to decrease costs of operations and improve processing efficiency. In many of these modernization and re-engineering efforts, processes that are technically similar to data center consolidation are being implemented which put technical, physical, and personnel controls on access to information in these systems. New technology and procedural controls are continually being developed to improve these controls within an environment that allows authorized access. There are, however, real and perceived risks associated with consolidation of wage data from its currently disparate locations. At the same time, this makes STAWRS different from many other data center consolidation activities. Careful attention must be paid to the limitations on access and disclosure. STAWRS design and implementation must be built on a sound technical and procedural base. Through such a concerted privacy, disclosure, and security program, it may be possible to further improve the current multi-agency state and Federal systems which are sometimes difficult to monitor, control, and audit.

Consolidation of multiple agency activities in the context of WRSP will require that the Federal and state laws, regulations, and procedures (relating to the authority to obtain, retain, secure, modify, and disclose data) be reviewed and modified as necessary to meet the

operational needs of a WRSP environment, while at the same time protecting the rights of employers and individuals.

A security policy, which describes what data may be disseminated for what purposes and who may have access to these data, must be an integral part of STAWRS. This policy will, at a minimum, identify: (1) sensitive information resources, (2) authorized needs for access to these resources, (3) classes of individuals that have these needs, and (4) limitations on secondary use and dissemination of information.

Privacy and Disclosure Issues

Current privacy, disclosure, and confidentiality legislation protects individuals while allowing the government to perform its missions. Assurances with appropriate enforcement policies will govern STAWRS operation in order to prevent data from misuse or use for unauthorized purposes in the face of good public policy arguments to do so. Numerous Federal laws concerning privacy, disclosure, and confidentiality all impact the nature and use of data for tax and related purposes. These include, among other, the following.

- The Internal Revenue Code, Section 6103, Confidentiality and Disclosure, specifically defines returns and return information with respect to taxes, and describes to whom it may be disclosed. The approach makes such information confidential and then provides specific exceptions for disclosure to taxpayer designees, state tax officials, and state and local law enforcement agencies.
- The Privacy Act limits the information maintained by a Federal agency about an individual to that needed to accomplish the purpose of the agency. The Privacy Act also requires data that is maintained to be accurate.
- The Social Security Act contains a Confidentiality Requirement in Section 303 that addresses the administration of unemployment compensation at the state and Federal levels, and the use of unemployment compensation payments to satisfy child support obligations. This act also contains numerous clauses concerning the disclosure of information for a variety of purposes and to specified individuals.

In addition to these and other Federal statutes, each state has its own privacy, disclosure, and freedom of information laws. States are concerned about their rights to use data they now collect for their own purposes. Many states already have data sharing agreements with other states that describe what information is to be shared, what secondary disclosure is permitted, and what the allowable uses are for the data. Some of these agreements also address informed consent and data retention.

To carry out WRSP functions, two classes of data may be retained: entity or identification data and tax/wage data. In the course of WRSP efforts to date, concerns have been raised with respect to both classes of data. Although the operational concepts for WRSP described in Section 4 do not envision the disclosure of either class of information to anyone other than an authorized entity, the integrated registration, validation of SSN, and customization of submission packages are examples of functions of concern. SSA's requirement that US residents have a SSN has been recognized as a convenient and unique identifier. The SSN is now widely used by many organizations, such as motor vehicle administrations, universities, the armed services, insurance companies, and banks, as well as other government agencies. This creates a situation where a single identifier acts as a key to large quantities of data, and may become the means to significant information disclosure. For the past several years, SSA has been concerned about this issue, but a resolution regarding use and disclosure of SSNs has yet to be reached. The ability to implement some of these envisioned STAWRS features may be predicated upon resolution of this issue as well as the use of a single identifier system for employers.

The potential use of a single source of data for multiple uses raises additional issues. For example, W-2 earnings data are not only to calculate Federal and state income taxes, but also to determine entitlement to unemployment and other benefits, as well as to determine other obligations. Today, specific authorization exists, for example, for employment wage data collected by Federal agencies and employment security agencies to be used for child support enforcement. Such authorized uses at the Federal and state level may be in consort or conflict. As such, in implementing STAWRS, all related laws and regulations will have to be reviewed to assure required privacy and adherence to public policy. Given the likelihood of conflicting requirements, some existing laws may have to be changed to allow WRSP participation by some agencies.

Ownership of Data

Ownership of data relates to the authority to obtain, retain, and modify data maintained by an organization, and the liability for correctness and timeliness of these data. These issues are directly and indirectly related to privacy, disclosure, and security.

The authority to obtain data is an integral part of the laws and regulations governing all of the potential agencies that may participate in WRSP. Each will have to review and, as desirable, modify these laws and regulations with respect to its ability to use WRSP services. In addition, Federal, and possibly state, regulations (such as the Federal Paper Work Reduction Act, which requires OMB approval of all Federal forms used to collect data from the public) will have to be reviewed with respect to oversight of WRSP returns.

Retention of data in WRSP data stores may present a number of issue. Within the various STAWRS concepts presented in Section 4 of this document, at least four issues exist. The first deals with data needed to prepare and distribute submission packages and to validate

submitted data from employers (e.g., names and addresses, identification numbers, employer-specific tax rates, etc.). The second deals with the data needed to resolve return errors; in particular, the data from submission packages that must be put in suspense until the employer may be contacted and errors corrected. The third issue deals with data that would be maintained in WRSP data stores to provide employer account assistance and to manage distribution of revenues to participating agencies (e.g., payments received and distributed). And finally, the fourth issue deals with retention and/or distribution of data to participating agencies for claims processing and compliance support. Laws and regulations will have to be reviewed to assure that WRSP can retain these data for the purposes indicated.

In order for the data in WRSP to be of use by the participating agencies, it must be accurate and up-to-date. At the Federal level, the Privacy Act of 1974 requires that any Federal agency maintaining data of the nature that may be in STAWRS, be responsible for ensuring that these data are both accurate and timely. It is envisioned that amended returns and payment coupons submitted by an employer will be processed through WRSP, and amendments either distributed to the participating agencies or maintained in WRSP data stores. Similarly, delinquent WRSP returns obtained by any participating agency would be forwarded to STAWRS for processing. However, results of examinations, audits, and similar activities carried out by the participating agencies may identify errors in filed data, requiring corrections to be made in WRSP data stores and/or dissemination of these corrections to all appropriate participating agencies. Procedures will have to be worked out as to who has the authority to make such changes, who is responsible for the correctness of such data, and how agencies will be notified of modifications.

Responsibility and liability for the correctness of the data in WRSP goes beyond making changes to WRSP data stores, and addresses such issues as (1) when the data become WRSP data (e.g., when received by STAWRS either on paper or electronically, or when completeness and correctness of data are determined, including the presence of a signature or equivalent), (2) indemnification of employers for late payments and filings delayed in WRSP processing, and (3) correction of interest losses due to untimely transfers to agency accounts and trust funds.

Each of these areas relating to data ownership will require that codes, regulations, and acceptable procedures be implemented which are equitable, acceptable, and workable for all parties including the employer community.

Security Policy

It is envisioned that STAWRS will operate under a well-defined security policy, acceptable to all participating government agencies. The policy will provide guidance for development, operation, and use of information resources and systems managed by WRSP. Among other key issues, this security policy will address:

- Identification of sensitive information resources
- Authorized needs for access to these resources
- Classes of individuals that have these needs
- Appropriate administrative, physical, and technical safeguards
- Accountability
- Limitations on secondary use and dissemination of information
- Enforcement and penalties for unauthorized disclosure and security infringement
- Requirements of initial and periodic risk assessments to determine system vulnerabilities
- Risk mitigating measures (including not only computer and telecommunications measures, but also physical access, personnel screening, access to sensitive personnel information, reporting of security violations)
- Requirements for monitoring and audits
- Protection against natural and man-made disasters (including contingency and disaster recover planning)
- Applicability of policy and procedures to agents and contractors
- Security certification of hardware and software
- Security requirements during acquisition and servicing of related services and products

To the extent that technology is needed to implement a security policy, that technology is available today.

WRSP's security policy must be comprehensive, workable, and acceptable to all participating agencies. Implementation of the security policy may require changes to laws and regulations of participating governments to assure that conformance to the policy can be implemented in all jurisdictions. In addition, participating agencies would have to agree to periodic audits of conformance to security policy and to assure that they, in turn, carry out audits of entities to which they provide access to STAWRS-derived data.

6.5 WAGE CODE HARMONIZATION

Wage code harmonization is a concept discussed in Section 4 of this document. Much of the effort expended by employers to satisfy their wage reporting and tax payment obligations results from a multiplicity of wage-related definitions, schedules, and forms, each of which is subject to change. Just as the states were able to agree on the Uniform Commercial Code to simplify, clarify, and modernize the law governing commercial transactions, state and Federal agencies, and certainly employers, could benefit from implementing a harmonized wage code in order to realize the greatest potential of WRSP.

At this early stage of WRSP, the scope and ramifications of a more harmonized wage code are just beginning to be examined. To date, identified topics include:

- Definitions
- Wage components
- Coordination of filing periods and payment schedules
- Unified numbering system and registration
- Unified reporting formats and media options

Several key aspects of these topics are discussed in the following sections.

Employer/Employee

Today the definition of who is an employee varies by government agency and is associated with enabling legislation and regulations governing the roles and missions of those agencies. IRS and SSA have differing definitions. Some differences are set by dollar tolerance levels, others by occupation or other criteria. Some employers may not be subject to UI taxes even though they are subject to state and Federal income tax. Wage code harmonization should, as a goal, attempt to make more uniform the instances where a worker must be included in reporting.

Employers often prefer to have workers who are recognized as independent contractors. The use of independent contractors can often result in lower labor costs and a competitive advantage. Classification by an employer of a worker as an independent contractor is sometimes questionable or ambiguous. This can further be confounded by *safe haven* protection of employers provided under Section 530 of the Internal Revenue Code. Examples of this are found in the janitorial services industry among others. Improper classification of workers as independent contractors may lead to loss of unemployment and Social Security benefits and reduced tax compliance by the worker.

IRS receives over 13,000 inquiries per year asking for a ruling on whether or not a worker should be classified as an independent contractor or as an employee. The issue of who is an employee can vary from jurisdiction to jurisdiction. Employers can be legitimately

confused by existing regulation. Harmonization should go some way to reducing this confusion.

Wage Components

As exemplified in Section 3.1 of this document, the definition of what constitutes wage for tax, withholding, and UI contributions varies significantly across government levels and agencies. Even at the Federal level, there are a variety of wage definitions and long lists of exceptions. Many of the variations are written into enabling legislation starting with the earliest tax laws and the Social Security Act of 1935.

At the state level, definitions vary even more widely, although there is a significant degree of harmony in Federal and state income tax definitions. Although it is estimated that 36 of the 42 income tax states are in essential harmony with the Federal income tax definitions, withholdings rules in these states vary significantly. The state SESAs experience a wider range of wage definitions and exceptions.

The wide array of variations in wage definitions and the inclusions and exclusions of many different and often focused components of wage are due to the fine political tuning that has occurred over many years at the state and Federal levels. Tax revenue code development has typically been connected to the budget setting process. Legislatures tend to tune the tax code and associated definitions in an attempt to provide adequate revenue and balance the budget while taking into account various economic base and social goals. Often these tax measures, which by their nature affect the definition of wages, are performed at the eleventh hour during pressured committee meetings.

If wage definition manipulation has value in helping to solve revenue and budgeting decisions, then wage definition harmonization must be shown to have countervailing advantages to make its adoption attractive to legislators. Initial input from the employer community has indicated a potentially large burden reduction through such harmonization. The government agencies can also offer some incentives to the legislators to the extent that government agency operations costs (with or without implementation of WRSP) are likely to fall under wage definition harmonization. Simplified wage definition results in simplified return forms and instructions, which, in turn, results in fewer employer errors. Fewer employer error results in less work performed by state and Federal agencies in correcting and cleaning up the data.

Reporting Format and Frequency

As discussed in Section 4 of this document, each of the alternative WRSP concepts contemplates annualization of the quarterly employment tax return, continued quarterly filing of UI wage reports, and a consolidated payment schedule that meets the needs of participating agencies. There are ongoing efforts to move from quarterly employment tax filing at the

Federal level (e.g., Forms 941 and 942) to an annual filing frequency. Reducing quarterly filing of employment tax returns reduces submission processing costs for both the employers and the government. However, in addition to changing filing procedures, there are both compliance-related concerns and administrative concerns for related programs -- as, for example, the Bureau of Census use of Form 941 data for development of statistical reports and the SSA use of Form 941 data for management of its trust accounts -- that must be addressed prior to the adoption of an annual reporting requirement. States as well as the Federal Government may move to an annual employment tax reporting as long as these compliance issues can be resolved. The use of a payment alert system has been advanced as a method of maintaining high compliance. This and other compliance alternatives need to be examined in order not to compromise compliance through combined Federal/state filing and annualization.

Payment Format and Frequency

Levels 1 and 2 incorporate joint payments of tax liabilities across government agencies. In both Levels 1 and 2, a single payment would cover multiple taxes and would be allocated to participating agencies according to employer designation or to some predefined method of allocating under or over payments. Today, the Federal Government and the states have a variety of required payment schedules that generally vary by size of the employer's liability. Although Federal revenue payment frequency requirements in many cases have been mirrored by the state revenue agencies, payment frequency differences constitute the largest filing schedule diversity found thus far in the WRSP effort.

Formats for joint payments require the development of a combined payment form similar to coupons used by some states today and/or the adoption of compatible methods of electronic payment. The FTD coupon, on the other hand, does not provide for payment of multiple liabilities.

Thus, harmonizing payment schedules, allocation designation, and methods for handling long and short payments may require further Federal and state regulatory effort.

6.6 A STRATEGY FOR ADDRESSING THE INSTITUTIONAL, LEGAL, AND REGULATORY ISSUES WHICH MAY IMPACT WRSP

As discussed at the beginning of this section, there are many factors of a non-technical nature which will affect the success of WRSP independently of its ultimate scope and functionality. Addressing these issues may best start with the formulation of a strategic plan for involving the key stakeholders, identifying the major components of required omnibus legislation, and formulating an approach to obtain a buy-in by the participating agencies and

governments. Concomitant with the formulation of such a plan, it has been suggested that an effort be initiated at the Federal level to better align Federal laws and regulations, which could then act as an example for a more widespread effort.

GLOSSARY

ADP	Automated Data Processing
AICPA	American Institute of Certified Public Accountants
AOC	Advice on Credit
BLS	Bureau of Labor Statistics
BMF	Business Master File
BNA	Bureau of National Affairs
CAG	Commissioner's Advisory Group
CAWR	Combined Annual Wage Reporting
COCO	Contractor-Owned/Contractor-Operated
CPA	Certified Public Accountant
DHHS	Department of Health and Human Services
DMF	Data Management Facility
DOL	Department of Labor
EDI	Electronic Data Interchange
ESS	Electronic Service System
FICA	Federal Insurance Contributions Act
FTA	Federation of Taxation Administrators
FTD	Federal Tax Deposit
FTE	Full-Time Equivalent
FUTA	Federal Unemployment Tax
GOCO	Government-Owned/Contractor-Operated
ICESA	Interstate Conference of Employment Security Agencies
IMF	Individual Master File
IRS	Internal Revenue Service
LAN	Local Area Network
MCC	Martinsburg Computing Center
NAEA	National Association of Enrolled Agents
NFIB	National Federation of Independent Businesses
NIST	National Institute of Standards and Technology

O&M	Operations and Maintenance
OCR	Optical Character Recognition
OMB	Office of Management and Budget
PC	Personal Computer
PIN	Personal Identification Number
SBA	Standards-Based Architecture
SESA	State Employment Security Agency
SPF	Submission Processing Facility
SSA	Social Security Administration
SSN	Social Security Number
STAWRS	Simplified Tax and Wage Reporting System
TIN	Taxpayer Identification Number
TT&L	Treasury Tax and Loan
UI	Unemployment Insurance
UIN	Unified Identification Number
UIS	Unemployment Insurance Service
USF	User Services Facility
WRSP	Wage Reporting Simplification Project